PUBLIC POLICY

A YEARBOOK OF THE GRADUATE SCHOOL OF PUBLIC ADMINISTRATION, HARVARD UNIVERSITY

1941

EDITED BY C. J. FRIEDRICH AND EDWARD S. MASON

ASSOCIATE EDITOR, PENDLETON HERRING

CAMBRIDGE, MASSACHUSETTS

GRADUATE SCHOOL OF PUBLIC ADMINISTRATION

1941

PRINTED AT THE VERMONT PRINTING COMPANY
BRATTLEBORO, VERMONT, U. S. A.

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PART I

BUDGETARY AND FISCAL PROBLEMS

THE GOVERNMENT AND THE BANK OF FRANCE*

Karl R. Bopp

SUMMARY

SINCE the policy of the Bank of France had important repercussions throughout France, its management periodically came into conflict with the government. Early experiments with paper money in France had created widespread distrust of governmental control over the issue of money. At the outset, therefore, the Bank was created as an independent institution under the control of powerful financial interests. Its prestige in monetary matters exceeded that of the government; and the periodic inflations or crises which followed unwise fiscal policies added to the prestige of the Bank and subtracted from that of the government. The government of the day occasionally recognized this state of affairs by passing statutes which limited its access to the Bank. The strength of the Bank was increased farther under the Third Republic by the weakness of the cabinet.

Despite the power of the Bank, the government occasionally forced it to change its policy. A strong executive, such as Napoleon, would brook no opposition, even from the Bank. It also acceded to the demands of the government in periods of great national difficulties, such as 1830, 1848, and 1914. Finally, after the Bank had followed an unpopular policy for several years, it was forced to yield after the electorate had voted against it in a rather clear test of strength in 1936.

An important factor in a number of conflicts between the Bank and the government has been the personality of the representatives of the two institutions. Gambetta was able to achieve his ends against Cuvier; whereas, de Ploeuch was able to outmaneuver the representatives of the Commune.

THE EDITORS

* The author is indebted to the John Simon Guggenheim Memorial Foundation and to the Social Science Research Council for awards of fellowships and to the Research Council of the University of Missouri for a grant to study the policies of central banks.

References to the annual reports of the Bank of France for the years 1820 to date are to originals (Library of the University of Chicago); references for the years 1800 to 1819 are to apparently (from internal evidence) reprints (Library of Harvard University).

EXCELLENT studies have been made of the profound effects of central bank policies upon the welfare of nations. Such studies lie largely or wholly in the realm called economics. As such, they are concerned primarily with the effects of policies once they have been initiated and only incidentally with how the policy itself came into being. Studies of the determination of policy lie in the realm called politics. But since students of politics are largely concerned with governmental affairs in the narrower sense, they too touch the determination of policy by central banks and similar institutions only incidentally. Yet the mines of information contain rich ore for the student who is interested in what might be called the political determination of the policies of administrative economic institutions. The present essay, which lies in this field, is concerned primarily with the factors which have proved decisive in the periodic struggles between the French government and the Bank of France over the policy which the latter should adopt.

The Bank of France has been battered at times almost beyond recognition by the government of the day, but it has survived most of its tormentors. Founded by Napoleon, it functioned under the Bourbon Restoration, the House of Orleans, the Second Republic, the Empire of Louis Napoleon, the Third Republic, and still serves the France of today. Yet it is not a chameleon which passively adapts itself merely to survive. It too at times has dealt stunning and even mortal blows to governments. A study which confined itself to the law would be inadequate. There were no significant changes in the law concerning the administration of the Bank for a hundred and thirty years of this period. But this statement taken alone gives a wholly misleading impression of the balance of power which determined its policy. The law of 1806, which censor Martin said gave the state the power to govern and direct the Bank and reduced the powers of the shareholders to mere surveillance[1] is the same law against which the Popular Front directed its campaign because it gave the shareholders complete control and denied the government all power!

The conclusion may be stated in very general terms at the outset. Powerful private financial institutions are continuously

[1] Banque de France, *Assemblée Générale des Actionnaires de la Banque de France du 27 janvier 1814: Compte Rendu au nom du conseil général de la Banque de France et Rapport de MM. les censeurs*, pp. 24–25.

interested in the policy of the Bank. Furthermore, they usually exercise control over it. When they are not exercising control, they are biding their time or are actively—though perhaps quietly—attempting to regain it. Only intermittently—and not continuously—the government is very much interested in Bank policy. Even then, if the government is weak, it may not succeed in capturing control. If it is strong, the government will be successful. But the government may weaken; and the interest of even a strong government is apt shortly to focus elsewhere upon newer pressing problems. It is at these junctures that the vigilant financial group makes its bid to recapture control.

THE STRENGTH OF THE BANK

Prestige

The strength of the Bank derives from a number of sources. In the first place, it has accumulated a great prestige. Professor Rogers said: "Probably no banking institution in the world, with the possible exception of the Bank of England, has ever commanded more general respect and esteem. A Frenchman may lose faith in his Government—as he often does—but never in his Bank."[2]

The public trusted a private institution to manage credit better than the government. This was true not only of the great financial interests but of the underlying population as well. France had experienced two great inflations, one early in the eighteenth century and the other near its close. Both the system of John Law and that of the assignats failed when government needs led to excessive issues of notes. These experiences explain why the consular announcement of January 18, 1800, that government funds would be deposited in "the Bank of France,"[3] aroused serious doubts in Paris concerning the success of any proposed bank which might be established under the auspices of the government.[4] It is significant that

[2] J. H. Rogers, *The Process of Inflation in France: 1914–1927* (New York, 1929), p. 339.

[3] Banque de France, *Lois et statuts qui régissent la Banque de France* (Paris, 1931), p. 5.

[4] A. Aulard, *Paris sous le consulat* (Collection de documents relatifs a l'histoire de Paris pendant la révolution français) (Paris, 1903–1909), vol. I, pp. 118, 121 (Reports of the minister of police and of the central bureau). The difficulties encountered in raising the original thirty millions of capital are described in the *Rapport des Régents le 24 pluviôse an VIII*, reprinted in Octave Noël, *Les banques d'émission en europe* (Paris, 1888), vol. I, pp. 587–596.

the Bank was not created by special act of government. Its original statutes were agreed upon by a general assembly of stockholders on February 13, 1800.[5] The government as well as Napoleon and members of his immediate circle subscribed to the stock.[6]

Partially from conviction, partially as a suggestion to Napoleon as well as to reassure the public, the first president described the position of the Bank vis-à-vis the government in terms which are classic:

> It is to be noted particularly that the Bank of France by the fact alone of the character of generality upon which it is established, is not governmental: free by its creation which concerns only individuals, independent by its statutes, emancipated from the conditions which a private contract with the government or a legislative act would have imposed upon it, it exists under the protection of the general laws and exclusively by the collective will of its shareholders. When it deals with the government, its transactions assume the character which they must have with a free government: it does not negotiate with the government except when it is treated with due consideration and with respect for its guarantees; finally, it is absolutely outside the government.
>
> Actually, the relations between the government and the Bank are capable of great expansion; that is a natural result of the transactions of the government, in view of their volume; and this result does not arise from any injection of favor or preference.[7]

Although this is probably an accurate description of the conditions at the time,[8] the Bank did not maintain its independence. It is significant, however, that despite its failure to do so, the Bank gained prestige following the periods of governmental pressure when such periods were accompanied or followed by great credit disturbances. These disturbances were taken as proof of the popular belief that the Bank should

[5] Banque de France, *Lois et statuts*, p. 7.

[6] *Archives parlementaire de 1787 à 1860*, deuxieme serie, April 4, 1803, vol. IV, p. 559.

[7] Banque de France, *Assemblée Générale du 25 vendemiaire an IX*, pp. 17–18.

[8] One wonders a little about the frequency with which the management insisted upon the independence of the Bank. See Banque de France, *Assemblée Générale du 25 vendemiaire an IX*, p. 32, *Assemblée Générale du 20 vendemiaire an XI*, p. 18 (Both statements by censor Journu-Auber). Perregaux, an outstanding personality at the Bank, kept Napoleon informed of the condition of the institution, Gabriel Ramon, *Histoire de la Banque de France* (Paris, 1929), p. 47. See also Alphonse Courtois, *Histoire de la Banque de France* (Paris, 1875), p. 95, and Octave Noël, *op. cit.*, pp. 98–99.

be independent. Hence the Bank, though it yielded occasionally to the government, usually gained prestige and recovered its independence.

An interesting case occurred shortly after the foundation. Following the panic of 1802 and when a new war with England was imminent, Napoleon became interested. Upon the advice of Mollien[9] the law of April 14, 1803, the first law relating specifically to the Bank, was passed. It chartered the Bank for fifteen years and gave it exclusive powers to issue notes in Paris. The monopoly added greatly to its prestige, but it also increased the obligations of the Bank to Napoleon. The law did not give the government formal representation in its management, but the Bank gradually yielded to pressure from the government. After several more or less voluntary extensions of credit to the treasury and to the government tax collectors, the Bank asserted its independence and refused, on October 22, 1803, to make another loan. The treasury insisted, and the Bank finally loaned six of the ten millions which were requested. A month later the treasury wanted an additional twenty millions. This also was refused; and on November 27, the prefecture of police of Paris reported:

> Commercial circles are much concerned with the Bank of France. It is said that the government has asked it for twenty millions, which have been refused under the pretext of lack of funds; that it is citizen Perregaux who is particularly opposed to this loan and especially to the issue of fifteen millions of shares which are in reserve, announcing that the Bank would be totally lost if they submitted to the action of the government; that he added that if the old regime of the Bank were not reëstablished, they would have to say farewell forever to confidence and to public credit.[10]

But the Bank compromised with the treasury for ten millions. It sent a deputation to Napoleon to call his attention to the law which empowered the Bank to discount only bills of exchange and other commercial instruments. Napoleon replied to the Bank via Barbé-Marbois, Minister of the Treasury.[11] It was not his intention, he said, for the treasury to borrow from

[9] François Mollien, *Mémoires d'un ministre du trésor public* (Paris, 1898), vol. I, especially pp. 303–304, 340.

[10] Aulard, *op. cit.*, vol. IV, p. 531.

[11] *Correspondance de Napoléon Ier*, Plon edition, 32 volumes, (Paris, 1858–1870), Letter of January 25, 1804, vol. IX, pp. 218–219.

the Bank (apparently he meant on long term), but he had always supposed that regular government bills of less than two months echeance were *discountable* as a matter of right. "Vous voudrez bien donc me déclarer positivement si les effets de cette nature seront escomptés sans difficulté." In his desperate search for funds Barbé-Marbois put pressure upon the Bank to lend to the treasury indirectly through the Associated Merchants, the firm name for three government contractors and unscrupulous speculators.[12] Finally, the Bank had a million and a half in reserves and ninety-two millions in liabilities. Perregaux wrote to Napoleon that the object of the Bank was "above all, a desire to merit the good-will of the Emperor."[13] The Emperor, however, blamed the severe crisis which followed upon the improper management of the Bank because it was dominated by bankers.[14] He reorganized the management and placed it more under his own control.

But although the Bank was subservient to Napoleon during his reign, it remained after he was exiled. The responsibility for the crisis of 1805 was transferred from the shoulders of the Bank—where Napoleon had placed it—to those of Napoleon himself.[15] That crisis now became but another illustration of the effects which "one might expect" when the government has too ready access to the monetary authority. The management was encouraged by Louis, provisional minister of finance, who said that the new government would avoid the errors of Napoleon and that it would neglect nothing to extinguish the debt to the Bank. As earnest, he appointed Laffitte, a regent, as provisional governor to replace Jaubert. Although the Bank was unsuccessful in its attempts to secure legal reform of its management, Laffitte said it had in fact "the most perfect independence under the legitimate surveillance of authority."[16] Thus the Bank of France, though subservient to Napoleon, emerged into Bourbon Restoration with renewed prestige.

[12] The best account of the entire affair is that given in Otto Wolff, *Die Geschäfte des Herrn Ouvrard* (Frankfurt, 1933), pp. 100–148.

[13] Cited by Ramon, *op. cit.*, p. 73, from Archives Nationales, AF. IV, 1071.

[14] *Correspondance*, Letters of August 9, 20, 24, 28, 1805, vol. XI, pp. 71–72, 105, 124–126, 149.

[15] Banque de France, *Assemblée du 15 novembre 1814*, reprinted in *Assemblée Générale du 27 janvier 1814*, p. 26.

[16] Banque de France, *Assemblée Générale du 25 janvier 1816*, p. 23; *Assemblée Générale du 30 janvier 1817*, p. 10.

Not all conflicts with the government, however, fit this pattern. There were times when the consequences of a possible inflation were *deliberately* preferred by the government. Such was the case in 1870 when the provisional government was organizing resistance to the Prussians, who were besieging Paris. Again the Bank loaned only under compulsion from the government.[17] One might suppose that this refusal to coöperate in a period of national emergency would have tended to great loss of prestige. But such was not the case. The Bank soon reversed its policy, aided the government to pay the reparations, and gained further plaudits for its coöperation. Until the great depression of the 1930's the Bank always managed to escape widespread, popular disapproval.

As a result of its conflicts with the government the Bank seldom lost prestige and usually gained it in the long run. Some other central banks, however, have lost prestige because of business depressions which have been attributed to their policies. Until recently the Bank of France had the good fortune to have crises, depressions, and similar convulsions attributed either to the government for interference with "natural economic laws" (1805) or to the operation of such laws without the "aid" of governmental interference. In 1865, Governor Rouland testified that commercial, industrial, and monetary crises occur because God had attached a fatal law to all things human: "Excès et imprévoyance."[18] Even when it was suggested that bank policy might somehow be involved, the Bank and others advanced quieting arguments. They demonstrated in annual reports and elsewhere that interest rates and especially bank rate were both lower and more stable in France than anywhere else. Furthermore, the Bank claimed never to refuse "legitimate" demands for credit in periods of *gêne*.

It should not be imagined from the foregoing that the prestige of the Bank remained wholly unchallenged. A long list of persons could be cited who levelled attacks against the Bank and its management. Victor Hugo accused it of financing the coup d'État of Napoleon III. Gambetta's bitter despatches of 1870 were published in the report of the government on the events

[17] See below, pp. 31–34.

[18] Ministère des Finances et Ministère de l'Agriculture, du Commerce et des Travaux Publics, *Enquête sur les principes et les faits généraux qui regissent la circulation monétaire et fiduciaire*, 6 volumes, (Paris, 1867–1869), vol. II, p. 672.

of that year.[19] Barbé-Marbois,[20] Pelletan,[21] and Viviani,[22] to mention only a few, countered eulogies of the Bank in Parliament with denunciations.

But generally speaking, as one reads books on the Bank of France and typical speeches or reports of Parliament, he gains the impression that it was considered somehow unpatriotic to find fault with the great national institution known as the Bank of France. National pride in "our Bank" precluded even unfavorable comparisons with other central banks.

Government Confidence

A second source of strength of the Bank derived from the fact that the government of the day usually trusted the Bank more than its own successors in office. It therefore passed laws which restricted its successors. A clear illustration is to be found in the history of the legal limitations upon note issues and loans by the Bank to the government. Until 1848, redemption was considered adequate protection against excessive issues; and the Bank was not subjected either to reserve requirements or to limitation of maximum issues. When redemption was suspended on March 15, 1848, however, it was thought that the public might lose confidence in the notes and that they might follow the path of the assignats unless the public were convinced that the volume of notes was definitely limited. To maintain confidence, therefore, the law limited the amount of notes which the Bank was authorized to issue.[23] The limitation was dropped with the return to specie payments.

A limit was restored on August 12, 1870, when redemption was again suspended. This time, however, the limit was not dropped when specie payments were restored. This was a negative act of Parliament, and little was said about it at the time. But it seems clear that the reason was more nearly distrust of the Ministry of Finance than of the Bank.[24] The only argument that was ever advanced for retaining the principle of limitation

[19] Assemblée nationale, *Enquête parlementaire sur les actes du gouvernement de la défense nationale, Rapport No. 1416, H.* (Versailles, 1873).
[20] *Archives parlementaire,* December 1 and 17, 1814, vol. XIII, pp. 749–752, vol. XIV, pp. 153–162.
[21] *Journal officiel, Débats, Chambre,* June 1 and 3, 1897, pp. 1359–1372, 1385–1391.
[22] *Ibid.,* June 10, 1897, pp. 1436–1441, December 22, 1911, pp. 4177–4182.
[23] The limit was increased twice during the period.
[24] *Journal officiel, Documents parlementaires, Sénat,* 1897, p. 570.

is that it was needed to restrain the Minister of Finance.[25] One interesting variation occurred in the argument. In 1897, Buffet opposed an increase of a billion francs in the limit and preferred to abandon the limit entirely to such a large increase. His argument was that if there were no limit, the Bank could refuse the minister on financial grounds; but if a limit were established so far in excess of the actual circulation, the minister could argue that Parliament had obliged the Bank to lend.[26] Ordinarily it was those who did not fear the minister or who did not think that the limit was a really effective check who favored abandonment.[27]

Experience with the limit shows clearly that it was not designed to prevent an expansion of notes which might be occasioned by an increase in the general volume of business (rather than needs of the treasury). In response to a query, Governor Pallain said, on July 21, 1906:

> . . . from the fact that these increases were approved by legislative authority every time that the outstanding circulation of notes approached the legal limit, it resulted that in reality the issue has up to the present time followed the demands of commerce.[28]

The real function of the limit was to aid the Chamber in its control over the finance ministry. One exception was allowed. As part of the program that was called financial preparedness, the government concluded successive secret agreements with the Bank whereby the latter agreed to make advances to the treasury in the event of mobilization. The details of these agreements, of course, were not known; but their existence was known and was generally approved.[29] During the war of 1914–1918 the government was not expected to justify its every act publicly. Consequently, from August 5, 1914, until March 5, 1919, the limit could be raised by cabinet decree. But after the

[25] *Journal officiel, Débats, Sénat,* January 25, 1884, especially pp. 154–159; November 4, 1897, especially pp. 1274–1277.

[26] *Ibid.*, November 5, 1897, p. 1285.

[27] *Ibid.*, January 25, 1884 (Denormandie) pp. 149–154; (Leon Say) pp. 161–164.

[28] Chamber of Commerce of the State of New York, *The Currency*, Report by the Special Committee submitted to the Chamber October 4, 1906, p. 29.

[29] *Journal officiel, Débats, Chambre,* June 10, 1897, pp. 1446–1448. The last of these agreements, that of 1911, was implemented by the general mobilization in the war of 1914–1918. Under its terms the Bank agreed to advance 2.9 billion francs.

war Parliament resumed its powers by requiring formal consent to raise the limit. The difficulties which arose will be described in another section.[30]

Occasionally the government resorted to subterfuges to avoid the spirit and even the letter of the law. For example, soon after Napoleon abdicated, Louis, provisional Minister of Finance, hastily replaced Governor Jaubert. The haste was occasioned by the fact that Jaubert, faithful to Napoleon, had delegated his functions—in accordance with the law—to Deputy-Governor Thibon while he joined Empress Marie-Louise. Louis seized upon Jaubert's absence to appoint Laffitte *provisional* governor and simultaneously denied Jaubert the right to resume his position. Laffitte was a regent, and it may be presumed that he had been recommended by the regents themselves. He did not abandon his private activities but became merely "first" regent and refused to accept the large salary which went with the office.[31] There was nothing "illegal" about this appointment. The government had the power to appoint the governor. But the procedure was strange. The law said nothing about *provisional* governors. It clearly implied that the governor should be the active executive at the Bank and should not have extensive outside occupations. Furthermore, he was not legally allowed to discount at the Bank; and no refusal to accept a salary made him eligible to do so. Gaudin pointed out these facts when he, in turn, was appointed to replace Laffitte.[32]

A similar case arose in 1936. On June 7, Tannery was replaced as governor of the Bank. Apparently Labeyrie did not possess the hundred qualifying shares and was not legally eligible for the governorship. The decree, therefore, did not name him governor but charged him with the functions of the governor instead.[33] The most important violation of the law is reported in another section.[34]

[30] See below, pp. 13–18.

[31] Concerning Laffitte see Jacques Laffitte, *Mémoires de Laffitte: 1767–1844* (Paris, 1932).

[32] Martin Gaudin, *Mémoires, souvenirs, opinions, et écrits du Duc de Gaëte* (Paris, 1826), vol. I, pp. 49–56.

[33] The decree (*Journal officiel*, January 3, 1935) which named Tannery read: "M. Tannery . . . est nommé gouverneur de la Banque de France." The decree (*Journal officiel*, June 7, 1936) which named Labeyrie read: "M. Labeyrie . . . est chargé des fonctions de gouverneur de la Banque de France."

[34] See below, pp. 13–15.

The Political Power of the Bank: Cabinet Weakness

Much attention has been directed in recent years toward the political powers of the Bank of France. To comprehend the discussions it is necessary to analyse briefly the French political system.

> In France, no political party in practice *ever* has a majority of the members of the Chamber of Deputies, and, consequently, the Council of Ministers is composed of leaders of a number of party groups. Its power is thus always based upon agreements and compromises, and the party groups of the Chamber of Deputies are the masters of the cabinet. The 'alliances,' 'unions,' 'blocs,' 'cartels,' and 'fronts,' formed for the conduct of elections and as agreements on governing, lead precarious existences. . . . The power of a French cabinet is an assembled power. The parts of the power structure do not fit harmoniously, and a slight shock may bring the structure quickly to the ground.[35]
>
> We have put our finger on the constitutional weakness of every French Government. If it accepts the assistance of the Left it will not be able to balance its budget, and it is also certain to run afoul of the commercial interests. If it turns to the Right, the interests will be appeased, but the reactionary influence it has to submit to is sure to antagonize the secular and democratic convictions of the masses. . . . The best Cabinet is one made up of members of the Left who are democratic, but not extreme enough to excite the business interests—I mean a mystic union of democracy, with a conservative as Finance Minister.[36]

The multi-party system with its strong chamber and weak cabinet underlies the political powers of the Bank. Several post-war cases will be reviewed to show how it operated.

It will be recalled[37] that Parliament placed a limit upon the amount of notes which the Bank was authorized to issue. It also limited the amount of loans which the Bank was authorized to extend to the treasury. After March 15, 1919, the cabinet was required to secure the consent of Parliament to increase these limits. Parliament became increasingly reluctant to grant further increases. The increase in July, 1919, was secured only with great difficulty. Rather than ask for another increase in

[35] J. G. Heinberg, *Comparative Major European Governments* (New York, 1937), pp. 158, 262. Copyright 1937. Reprinted by permission of the publishers, Farrar & Rinehart, Inc.

[36] Andre Siegfried, *France: A Study in Nationality* (New Haven: Yale University Press, 1930), pp. 60, 61. Reprinted by permission of the publishers.

[37] See above, pp. 10–12.

the limit of loans, the government adopted a subterfuge in October, 1920.[38] It requested private banks to lend the funds to the government. But since these banks did not always have the necessary funds, arrangements were made whereby the Bank of France agreed to lend them the required amounts by discount of commercial paper. Though nominally commercial advances, they were really merely indirect or "occult" advances to the treasury. This practice was followed at later times also. It violated the spirit but not the letter of the law.

In the last quarter of 1924 the actual note circulation approached the legal maximum of 41 billion francs. The governor kept the ministry informed. On December 29, 1924, he wrote a letter to the Minister of Finance and informed him that the limit was not exceeded only because of compensations which occurred when the statements of the branches were consolidated with that of the head office. The general council of the Bank agreed unanimously that an increase in the limit should be avoided if at all possible because it would ruin the credit of the country and open the door to a progressive inflation which neither the government nor the Bank either desired or could control.[39]

On February 5, 1925, the Governor wrote another letter. The general council did not anticipate any stoppage in the increase in circulation unless the government adopted a genuinely rigorous policy of reduction in all expenses. Since the weekly balance sheet would necessarily show that actual circulation exceeded the legal limit, the Bank requested the government to increase the limit with all the consequences that it would have.[40] Three weeks later, on February 26, the governor wrote yet another letter urging the government to change its general financial policy and to increase the legal maximum of note issues.

After a conference with several regents, the Premier wrote the Governor, on March 3, that they had agreed to delay action on the note issue until the end of March with the hope that the situation would improve. The government agreed with the earlier position of the Bank that an increase in the legal limit

[38] Speech of François-Marsal, *Journal officiel, Débats, Sénat*, April 10, 1925, p. 837.
[39] *Ibid.*, p. 840, where François-Marsal quotes the letter.
[40] *Ibid.*, p. 840.

should be avoided if at all possible.[41] On March 16, the Governor wrote again.[42] On April 1, Herriot replied that he planned to submit a proposal to Parliament on April 7.[43] On April 8, the Governor wrote once more informing the Minister of Finance that the Bank proposed to publish an accurate balance sheet on April 9, and that it would probably show a circulation of approximately 43 billion francs—2 billions beyond the limit—and a debit balance of 400 to 500 million francs in the current account of the treasury. "In view of this situation, the question will be presented to the general council whether in the absence of a vote from Parliament the Bank of France should continue its operations."[44]

The public disclosure that the Bank had falsified its statements under pressure from the government came as a bombshell.[45] Despite Herriot's appealing efforts to explain and justify his policy, his government was doomed.

These circumstances have been variously interpreted. Since the Bank falsified its statements under pressure from the government, it has been said that it was merely a government bureau.[46] On the other hand, in the then existing economic and political situation,[47] once the Bank could demonstrate that pressure had been exerted, far from being a mere bureau in the Ministry of Finance, it held a powerful weapon—threat of exposure—against the government itself. From this point at least *any conceivable action* of the Bank would have significant *political* consequences. The government was unwilling to regularize the situation by requesting Parliament to increase the limit, because it could not anticipate a favorable vote. The falsification, therefore, permitted the Herriot ministry to remain in power despite the probable wishes of a majority of Parliament had its members known the facts. But the exposure would further impair confidence at a time when it was universally agreed that confidence required bolstering. As long as the Bank had hope that the government would master the financial

[41] *Ibid.*, p. 842.
[42] Report of Berenger, *ibid.*, p. 865.
[43] *Ibid.*
[44] Letter quoted, *ibid.*, p. 842.
[45] *Journal officiel, Débats, Chambre*, April 7, 1925, p. 2097 (introduction of bill); p. 2112 (de Monzie); *Documents parlementaire, Chambre*, 1925, Annexe No. 1535, p. 592, *Exposé des motifs*.
[46] Rogers, *op. cit.*, p. 19.
[47] See R. M. Haig, *The Public Finances of Post-War France* (New York, 1929), pp. 25–179 for description.

problem, it made concessions; but when this hope expired, the situation was exposed.

Neither the crises of the franc nor disagreements between the government and the Bank ceased with the change in ministries. In June 1926, Minister of Finance Caillaux, wrote Governor Robineau:

> You gave new proof yesterday afternoon of your feeling of hostility against the government of which I am a member.
>
> It is inadmissible that the Bank of France, in a matter which concerns the defense of our currency or important political questions, should not place the general interest before its own preferences.
>
> I notify you that after today I charge my services to assure this defense and that I am resigned to doing without the collaboration that you refuse me.[48]

On June 26, Caillaux appointed Moreau governor of the Bank. Less than a month later, the government asked Parliament for emergency powers to rule by decree. On July 19, Herriot left the presidential chair to attack the Briand-Caillaux ministry; and Herriot became Premier and de Monzie became Minister of Finance.

This ministry soon discovered that finances had not improved since they had been defeated in April, 1925. In a desperate effort to secure cash, Caillaux had written to Moreau on July 15, 1926, suggesting that the Bank purchase the remainder of the so-called Morgan dollars in the possession of the government.[49] On July 19, the Governor replied. The Bank agreed to the proposal *except* that it insisted that the government request Parliament to increase the note limit sufficiently to meet the new issue of francs which would be occasioned by the purchase of the dollars.[50] Next morning Moreau visited de Monzie at the latter's request. According to Moreau, the minister and the under-secretaries were "stupefied" to discover the actual state of the treasury.[51] They blamed the situation

[48] *Journal officiel, Débats, Chambre,* July 16, 1936, p. 1957. The exact date of the letter is not given. It must have been between June 23 (when Caillaux became minister) and June 26 (when Moreau was appointed governor).

[49] On March 13, 1924, J. P. Morgan & Co. had negotiated a loan of one hundred million dollars to be used by the French government to "defend the franc." The Caillaux letter is published in *Journal officiel, Débats, Chambre,* July 21, 1926, p. 3018 and *ibid., Sénat,* p. 1379.

[50] *Ibid.*

[51] Emile Moreau, "Le relèvement financier et monetaire de la France (1926–1928): Souvenirs d'un gouverneur de la Banque de France," *Revue des deux mondes,* March 1, 1937, p. 56.

upon Caillaux and his predecessors. Moreau responded that: ". . . if the preceding ministry had been allowed to remain, it would have been easier to remedy the difficulties which assail us." He noticed that his "observation was not to the liking of his questioners." He thought: "that the sooner this ministry (*équipe ministérielle*), which has neither the experience nor the necessary authority, resigns, the better it will be for the country."[52] Herriot wished to avoid an adverse vote in Parliament and offered his resignation to President Doumergue, but it was not accepted. On July 21, Moreau informed de Monzie that the Bank would cut off all payments for the treasury unless it had resources with which to meet them. He recalled the earlier correspondence with Caillaux concerning the Morgan loan.[53] A law empowering the government to sell the remainder of the Morgan dollars to the Bank was introduced, but nothing was proposed with respect to the circulation limit. Immediately Moreau wrote to Herriot informing him that the general council of the Bank *conditioned* its willingness to buy the Morgan dollars upon an increase in the legal maximum.[54] The government thereupon introduced a new proposition to empower the government both to sell the dollars and to increase the limit. Addressing himself to the proposal, Vincent Auriol said that Caillaux had been opposed to the increase yesterday and de Monzie was opposed today. "It is no longer the government which makes the request. It is the government of the Bank of France which wishes once more to impose its will upon Parliament. . . . That is why we shall vote against the proposition of the commission. The Bank of France is not Parliament. Parliament before all. That is the meaning of our vote."[55] The Herriot ministry was defeated by a vote of 290 to 237. The new proposition of the Bank was voted, without posing the question of confidence, to care for the immediate needs of the treasury. A significant feature of this episode is the statement of the governor of the Bank. "The firm attitude of the Bank in obliging the government to disclose publicly the poor situation of the treasury, and in impeaching a return to

[52] *Ibid.*
[53] *Ibid.*, p. 58, *Journal officiel, Débats, Chambre*, July 21, 1926, pp. 3018–3019; *ibid.*, *Sénat*, p. 1379.
[54] *Ibid.*, *Chambre*, p. 3027.
[55] *Journal officiel, Débats, Chambre*, July 21, 1926, p. 3028.

illegal subterfuges, contributed appreciably to this result."[56] Former Minister de Monzie, in replying to Moreau, said: "I have not attempted to discover if, in provoking the fall of a government, M. Émile Moreau was in the limit of the normal functions of a governor of the Bank of France . . . and if the recognition of such initiative does not justify the reform of the statute of the Bank of France which was realised by the law of July 24, 1936."[57] Moreau countered that the Chamber of Deputies, not the Bank, reversed the ministry and that he had taken an oath when he entered the Bank ". . . de faire respecter son independance par le gouvernement *quel qu'il fût*, et d'empêcher celui-ci de violer les statuts de l'institut d'émission et les lois en vigueur."[58]

According to his own testimony, aid in the defeat of the Herriot ministry was not Moreau's last political act as governor. In the first half of 1928 the question was raised with increasing intensity should the franc be stabilized *de jure* at the existing level or should its value be increased? Poincaré wavered. Moreau told him definitely "that if the monetary reform is not accomplished by the ensuing July 15, I shall hand you my resignation and make public the reasons for my decision."[59] The franc was stabilized *de jure* at the *de facto* level in accord with the wishes of Moreau.

An interesting development took place in 1931 when England left the gold standard. As part of the stabilization program, the Bank of France had accumulated huge sterling assets. Although it had converted some of these into gold in the intervening years, it sustained a loss of about two and a half billion francs on the sterling assets which it held when the pound left gold. The Bank made no allowances for this in its weekly statements; but it wished to publish an "accurate"[60] balance sheet on December 24, 1931. It was proposed that the government reimburse the Bank for this loss. In the *Exposé des motifs*[61] the government argued that the Bank had really acquired the

[56] Emile Moreau, *op. cit.*, p. 61.
[57] "Correspondance," *Revue des deux mondes*, April 1, 1937, p. 683.
[58] *Ibid.*, p. 685. The law of 1936 changed the oath from ". . . to safeguard the laws and statutes of the Bank of France," to ". . . to safeguard the general interests of the country."
[59] *Op. cit.*, April 15, 1937, p. 826.
[60] Only a naive person would interpret "accurate" in the dictionary sense.
[61] *Journal officiel, Documents parlementaire, Chambre*, 1931, *Annexe No. 5885*, vol. II, pp. 400–401.

large sterling holdings in the public interest. It had long been concerned about converting them into gold; but to do so would have put pressure upon the London money market which the *government* and the Bank were loathe to do. Since the loss had been incurred for *la belle France*, the government should reimburse the Bank.

M. Léon Barèty reported the bill to the Chamber. He insisted above all that the new arrangement whereby the government would assume the loss should not have as a consequence the weakening of the autonomy of the Bank.[62] The representatives of the Bank certainly maintained their independence before the finance commission which examined the bill. The members wished to know, for example (as they had earlier wished to know concerning the Oustric affair), something about the accounts of the Bank, in particular the account entitled "Sundry Assets." As Nogaro said: ". . . we had the indiscretion to ask the commission of finance what various accounts contained. M. the minister of finance replied to us as one replies to too curious infants who wish to know things which are not for their age."[63] In short, the Bank wanted to maintain its complete independence; it "merely" wanted the government to shoulder the loss. After the discussion had lasted until the small hours of the morning, the Chamber, on a question of confidence, voted the government project: 321 to 269.

The next public announcement of a disagreement between the cabinet and the Bank of France was the decree published in the *Journal Officiel* of January 2, 1935, as follows:

> M. Moret is appointed honorary governor of the Bank of France,
> M. Tannery . . . is appointed governor of the Bank of France to replace M. Moret.

The immediate occasion for the decree was the refusal of the Bank to rediscount short-term treasury bills or to lend on them. The supremacy of the Chamber over the cabinet made it impossible for the latter to reduce public expenditures, and budgetary deficits had been increasing at a rapid rate. Private banks held about ten billions of treasury bills and were unwilling to absorb more without the right to rediscount them at the Bank of France.

[62] *Journal officiel, Débats, Chambre,* December 14, 1931, p. 4483.
[63] *Ibid.*, p. 4504.

The fundamental difficulty was that French prices were far above world prices especially since the devaluations in other countries. Two basic solutions were possible: one was to decrease the foreign exchange value of the franc—devaluation; the other was to increase the internal value of the franc—deflation.

The regents clearly favored deflation. They argued that the cabinet should demand of the Chamber a grant of powers to rule by decree and should then balance the budget by ruthless cuts in expenditures. Once the budget was balanced, they argued, there would be no further need for rediscounting.

The position of the government was less clear. Premier Flandin, M. Tannery, and Finance-Minister Germain-Martin, as well as the entire press took occasion at the time of the change in governorship to announce that there was no question of tampering with the franc under any circumstances.[64] In short, the cabinet opposed devaluation. At the same time, however, it opposed deflation, and M. Tannery was appointed to carry out an easier credit plan. The government desired to cover budget deficits with borrowings from the Bank. On January 25, the Chamber approved the government's plan to increase from ten to fifteen billion francs the limit of short-term government bills which the Bank might discount. On Tuesday, January 28, during the Senate debate on the bill, François de Wendel, regent of the Bank, complained in guarded terms against what the government was trying to force the Bank to do.

Flandin wanted the Bank to reduce its loan rates on all securities; but the regents refused, arguing that an increase in government bond prices should precede a decrease in the rate. Not until seven weeks after the appointment of Tannery did the Bank make a concession to the government.

The concession was inadequate. A sharp swing to the Left was registered in the municipal elections of May 5 and May 12. Even before the elections were completed, rumors of a financial crisis spread. Paul Reynaud, former Finance Minister, and others favored devaluation. But the government, probably for political purposes, announced its determination to defend the

[64] *New York Times*, January 13, 1935. P. J. Philip reported a radio speech of Premier Flandin in which he said: "The stability of the franc, to which we remain firmly attached, is and must be maintained."

franc at all costs and to balance the budget. Although various ministries recognized the merits of devaluation, none wished to be labelled with "the shame" of devaluation. The situation became acute by the middle of May. On May 22, Flandin, Germain-Martin, and Tannery conferred and agreed that Flandin should ask Parliament for full powers to deal with the situation as he saw fit by decrees. On May 23, the Bank raised its rate to 3 per cent, on May 25, to 4 per cent, and on May 28, to 6 per cent. Parliament convened on May 28. The following day the finance committee rejected the cabinet's request for special powers; and on May 31, despite appeal by Flandin (who made a personal appearance though he was still suffering from an automobile accident of early May), the deputies voted no confidence: 353 to 202.

The Chamber was so badly split into groups that a non-party cabinet was essential. M. Bouisson was (perhaps after Doumergue) the best choice for a non-party leader. His cabinet did not survive the first vote on his request for the right to govern by decree four days later. President Lebrun then asked no less than five men—Laval, Bouisson again, Jules Jeanneney, Pietri, Yvon Delbos—to head the government; but though some tried, they failed to form a cabinet. The efforts of M. Pietri may be described. His early efforts to secure the support of all parties except, of course, that of the Socialists and Communists, seemed successful. To secure the support of the Radical Socialists, however, he defined his position as follows:

> M. Pietri abandons the demand for full powers in the form that has been presented by the two preceding governments. He will be content to submit to the Chamber short bills permitting assurance of the defense of the franc and power to fight speculation accompanied by a request for powers of execution. Improvement of the budget situation will be realized by stages and with the help of Parliament.[65]

M. Pietri was able to assure the Radical Socialists that the Bank of France would not, as a matter of fact, refuse to rediscount treasury bonds; but he admitted in reply to a question the the Bank was free to do so or not as it pleased. The freedom of the Bank in this matter was the whole issue. The argument

[65] *New York Times*, June 7, 1935.

of the Left parties was that the Bank should be compelled to discount. Since the Radical Socialists refused to coöperate except on this basis, M. Pietri again journeyed to the representatives of the Bank. Shortly thereafter he informed President Lebrun that he could not continue his efforts to form a cabinet. It appears that the representatives of the Bank did not believe that the agreement with the Radical Socialists was adequate to defend the franc. They therefore demanded that Pietri ask full decree powers for budgetary deflation. Since he knew that the Radical Socialists would not grant such powers, and being personally averse as the head of the government to accept the dictation of the Bank, Pietri gave up. Lebrun then called upon Delbos to form a cabinet, but he refused. Finally, Laval was asked for the third time in a week to form a cabinet. He was granted emergency powers by a vote of 324 to 160 in the Chamber. Mr. H. L. Matthews reported that "the final result of the Laval government was a clean-cut victory for the Bank of France, and it has caused much bitterness on the Left side of Parliament."[66] Illustrative of this bitterness is the following quotation from the speech of Socialist deputy Leo Legrange in the debate which preceded the grant of decree powers to Laval: "There exists in our country a Bastille which is the stronghold of resistance to popular sovereignty and the Will of the State: the Bank of France and its Council of Regents."[67] This statement was followed by applause from the extreme Left and many benches of the Left. Francis Delaisi concluded a magazine article on the Bank of France with the following bitter words: "In earlier days, when the King was a minor, a Regent governed in his place. Democratic France now has twelve regents."[68]

THE STRENGTH OF THE GOVERNMENT

The Strong Executive

Despite the unquestioned strength of the Bank, the government has forced it to yield upon a number of occasions. In the first place, although the executive has usually been weak this

[66] *New York Times*, June 10, 1935.
[67] *Journal officiel, Chambre Débats*, June 5, 1935, p. 1804.
[68] Francis Delaisi, "Les maitres secrets de la France," *Vu*, vol. VIII, No. 380, June 26, 1935, p. 863.

has not always been true. France has had some "strong" executives.

Outstanding, of course, was Napoleon. The pressure of the treasury upon the Bank which culminated in the crisis of 1805 has already been described.[69] Although Perregaux said that the Bank yielded "to merit the good-will of the Emperor," it reckoned without its host. Napoleon blamed the crisis upon the excessive influence of the bankers in the management of the Bank, and he reorganized it. At councils of state he said: "I want the Bank to be in the hands of the government, but not too much so"; and "I must be master in all that concerns me, and above all with respect to the Bank, which is more important to the Emperor than to the stockholders because it manufactures money."[70] The law of 1806 carried out these wishes of the Emperor. It placed the Bank under a governor and two deputy-governors appointed by him. No act of the Bank was legal without the governor's signature. The powers of the general council selected by the stockholders were correspondingly reduced. On April 29, 1806, Napoleon wrote Gaudin, Minister of the Treasury, "I have appointed M. Cretet governor of the Bank and M. Thibon deputy-governor, because I know both personally." Subsequent events show that Napoleon knew Cretet very well indeed. When the Bank continued its rate at 6 per cent in the autumn of 1806 despite the small volume of bills presented, he wrote Gaudin from Berlin, "You must tell the governor of the Bank that I think it is scandalous in the present circumstances to discount at six per cent."[71] The Bank reduced its rate to 5 per cent. Following the Treaty of Tilsitt he wrote Gaudin from St. Cloud, "I wish you would have the governor of the Bank convene a meeting to put the rate at four per cent."[72] Again the Bank conformed to his wishes without delay.

These changes were made during the governorship of Cretet, the same Cretet, incidentally, who several years previously had memorialized Napoleon: "No Bank without complete independence!"[73] Small wonder that Napoleon rewarded him with

[69] See above, pp. 7–8.
[70] Pelet de la Lozere, *Opinions de Napoleon* (Paris, 1833), pp. 254–255, 257–258.
[71] *Correspondance*, Letter of November 14, 1806, vol. XIII, p. 531.
[72] *Correspondance*, Letter of July 31, 1807, vol. XV, p. 459.
[73] Cretet memorial digested by Ramon, *op. cit.*, p. 43, from Archives National, AF. IV, 1070.

an appointment as Minister of the Interior in August, 1807. As successor, Napoleon named Jaubert, another councillor of state, "but the real master remained the same."[74] In appreciation of the services of the Bank, Napoleon, on August 15, 1810, created barons of the deputy-governors, the four oldest regents, and the director of the Bank.[75]

"The National Necessities"

The government was also able to wring concessions from the Bank in periods of great national crisis. Ordinarily the government simply was not particularly interested in the policy of the Bank except as it affected certain technical administrative problems of government finance. The government usually was confronted with hosts of pressing problems. Only occasionally was bank policy clearly significant in their solution. Periodically, as during wars, revolutions, and severe depressions, however, the government was very much interested in Bank policy. And in the end it was able to force the Bank into line. The conditions under the Third Republic have been described by Professor Finer as follows: "only when a long accumulation of legislative, executive, and financial mistakes has disgusted the country and brought it within sight of domestic ruin and international disrepute, can the cabinet prevail, by threats and imagery of the dire results, upon the groups to accept its version of the national necessities."[76] During the "accumulation of mistakes" the cabinet could not force the Bank. But when a strong cabinet which was opposed to the Bank prevailed "upon the groups to accept *its* version of the national necessities," the Bank had to yield.

With due qualifications to allow for changes in political structures, this was true also of earlier periods. Thus, in 1830, the Bank loaned the new government sufficient funds to enable it to become established and care for its early needs. As Thiers said in 1840, "It gave us 30 millions, then 50. Finally it reached 130 millions at a time when the public would have neither

[74] Ramon, *op. cit.*, p. 88.
[75] Banque de France, *Assemblée Générale du 24 janvier 1811*, p. 15.
[76] Herman Finer, *The Theory and Practice of Modern Government* (New York, 1932), pp. 1051–1052.

rentes nor royal bonds.[77] Governor Gaudin expressed the matter in these words: "in these grave circumstances, the Bank of France has not fallen short of its duties."[78] It should be recalled that regent Laffitte, the former provisional governor, played an important part in the Revolution of 1830. He resigned his regency to become minister.

Again in 1848 the Bank was forced, finally, to lend. Practically with the outbreak of the Revolution in February, the Bank was besieged by bill holders who desired to discount and by note holders who desired coin. The Minister of Finance encouraged the Bank "to march firmly, to discount liberally, to redeem its notes at open counters, to double the number of counters, to master the deroute with the audacity of confidence."[79] The Bank followed this plan; "it is almost impossible for a credit institution to resist at a time of political revolution and when a social revolution is threatening."[80] On March 15, the Bank reported in despair to the minister that from February 26, until March 15, it had discounted 110 millions in Paris, and 43 millions in the provinces, that of the 125 million deposit of the treasury it had repaid 77 millions, that its reserve in Paris[81] had fallen from 140 millions on February 26, to 70 millions on March 14, and that over 10 millions more were paid out on March 15 alone.[82]

Clearly this could not continue much longer. "Struck with stupor" Governor d'Argout and the deputy-governors went to the Minister of Finance. D'Argout concluded his conversation with these words: "The small amount of coin that remains is owed to the state. It is indispensable for you in order to provision Paris, for the army, for the mobile guard, for the workers, for public work and public service. We are lost! What is to be done?"[83] "It was this last word of despair that the minister and the undersecretary of finance were awaiting to save the Bank by the state, the treasury by the Bank, France by the treasury and the Bank."[84] During the night of March

[77] Adolphe Thiers, *Discours parlementaires de M. Thiers* (Paris, 1879–1889), vol. V, p. 33; see also p. 12. Compare also the speech of Laffitte in the Chamber on April 11, 1834, *Archives parlementaire*, vol. LXXXVIII, p. 597.
[78] Banque de France, *Assemblée Générale du 27 janvier 1831*, p. 1.
[79] Garnier-Pages, *Histoire de la Revolution de 1848* (Paris, 1862), vol. VII, p. 29.
[80] Banque de France, *Assemblée Générale du 25 janvier 1849*, p. 3.
[81] The total reserve (Paris and provinces) was 226 millions in February.
[82] Banque de France, *op. cit.*, p. 1.
[83] Garnier-Pages, *op. cit.*, p. 30.
[84] *Ibid.*, p. 31.

15, the government decreed that Bank notes were legal tender and that the Bank would no longer be required to redeem its notes in cash. To maintain confidence it also decreed that the issue of Bank notes was limited to 350 millions and that the Bank must publish its balance sheet every week. In discussing the matter with d'Argout, Garnier-Pages said: "In this situation, where the state has saved you, it (the Bank) must save the state. What will you do for it? In 1830, you gave 100 millions; will you likewise give it 100 millions today?"[85] The governor agreed! Garnier-Pages recommended that the Bank request that the limit on note issues be placed at 350 millions rather than 300 millions because "the government will have need of you."[86] On March 31, 1848, the Bank loaned the treasury 50 million francs. On May 5, it loaned an additional 30 millions, not to the treasury directly, but to the Caisse des Dépots et Consignations.

The most important transaction, however, was the contract of June 30, 1848, which was ratified by the decree of July 5.[87] The Bank agreed to lend the treasury 150 millions; namely, 75 millions in July, August, and September, 1848, and an equal sum in January, February, and March, 1849. Repayment was scheduled to begin on April 15, 1850. Actually, the treasury borrowed only 50 millions instead of 75 millions in 1848 and borrowed nothing in 1849.

It is important to follow this contract with the government of 1848 because it forms the basis for the charge that the Bank of France helped finance the coup d'État of Louis Napoleon in 1851.[88]

On November 13, 1849, a new contract was signed whereby the "clauses and conditions" of the original contract were extended for one year. *Because of this extension*, so read article 2, the Bank agreed to make available the remaining 100 millions during the year 1850. The law of August 6, 1850, reduced the authorized limit of the original contract to 75 millions. Since the treasury had borrowed only 50 millions, there remained 25 millions. These are the "strategic" 25 millions.

[85] Ministère des Finances et Ministère de l'Agriculture, du Commerce et des Travaux Publics, *Enquête sur la circulation*, vol. II, p. 29.
[86] Garnier-Pages, *op. cit.*, vol. VII, p. 32.
[87] The contracts, decrees, and laws referred to in this discussion are published in Banque de France, *Lois et statuts*, pp. 121–132.
[88] Charge made, for example, by Pelletan in the Chamber on June 28, 1892, and by Berlioz on July 16, 1936.

Article 3 of the law provided that "the public treasury is authorized to extend for one year, in agreement with the Bank of France, the clauses, conditions, guarantees, and dates of repayment stipulated in the preceding contracts and relative to the first part (i.e. the 75 millions) of the loan approved by the decree of July 5, 1848."

On January 30, 1851, Governor d'Argout reported the existing position of the loan as follows: "The law of August 6, 1850, reduced to 75 millions the original credit of 150 millions. According to the echeances fixed by this same law, the 25 millions which would have completed the loan of 75 millions would cease to be available after December 31, 1850. Since the treasury has not used its right, the credit of 150 millions is definitively reduced to 50 millions."[89] In other words, in January 1851, d'Argout apparently interpreted article 3 to mean simply ". . . clauses, conditions, guarantees, and dates *of repayment* . . . of the loan."

A year later, however, on January 29, 1852, d'Argout reported that the loan of 75 millions "was not executed, except in part; the government, you know, did not avail itself of it except for the sum of 50 millions." In the fourth quarter of 1851, "the treasury reclaimed the last 25 millions. The general council of the Bank, in its meeting of November 27, last, recognized that this request was in conformity with the contract. The treasury was credited with these 25 millions on December 8."[90] Thus, the council of the Bank now seemed to interpret article 3 to mean: clauses of the loan, conditions of the loan, guarantees of the loan, and dates of repayment of the loan. D'Argout gave no explanation of this about-face. The significant feature, of course, is that the meeting of the general council at which the loan was approved was held just five days before the coup d'État. The treasury was not credited with the funds until six days after the coup; but it did not need funds immediately.

Even if the suspicions of the regents had not been aroused before, the meeting of November 27, must have informed them that something unusual "was in the wind." First of all, as has been mentioned, this meeting produced a complete revision in the Bank's interpretation of the old contract. In the second place, this revision was made and the loan granted even though

[89] Banque de France, *Assemblée Générale du 30 janvier 1851*, p. 6.
[90] Banque de France, *Assemblée Générale du 29 janvier 1852*, p. 5.

there was no *existing* embarrassment in treasury finances. The treasury balance at the Bank of France for the last three months of 1850 and the corresponding period of 1851 follow:

(*In millions*)

Oct. 3, 1850	56.7	Oct. 2, 1851	91.3
Oct. 10,	51.3	Oct. 9,	83.1
Oct. 17,	49.6	Oct. 16,	73.8
Oct. 24,	50.4	Oct. 23,	65.0
Oct. 31,	50.1	Oct. 30,	61.9
Nov. 7,	48.2	Nov. 6,	58.3
Nov. 14,	48.3	Nov. 13,	54.7
Nov. 21,	54.2	Nov. 20,	52.0
Nov. 28,	61.4	Nov. 27,	53.0
Dec. 5,	63.7	Dec. 4,	48.1
Dec. 12,	73.0	Dec. 11,	66.3
Dec. 19,	83.6	Dec. 18,	70.2
Dec. 26,	79.1	Dec. 26,	57.8

Source: *Moniteur.*

The weight of the evidence, therefore, points to complicity rather than to stupidity on the part of the management of the Bank in the coup.[91]

Electoral Victory

Immediately, the power of the government depends upon its ability to secure votes in Parliament; but in the end it depends upon the government's ability to secure votes in an election. This was shown clearly in 1936. The strength of the Bank in its opposition to the programs of the governments of the day (literally in some cases!) was shown in an earlier section. As long as the Bank opposed further inflation in a period of marked inflation, this did not make effective political ammunition. But when the Bank opposed credit expansion in the midst of severe depression, it became a major political issue.

For the first time the control of the Bank became a matter of widespread interest.[92] It was still functioning under the

[91] Major facts in the evidence of those who defend the Bank against the charge are: a) that the treasury balance at no time after the coup fell below 25 millions and that, therefore, it *could have been* financed without the loan and b) that the treasury negotiator was replaced by the coup. The rebuttals are: for a) that the loan was a precautionary measure, and for b) that it is not of sufficient weight to counterbalance the evidence on the other side.

[92] The matter of control had received attention in Parliament before this. On June 28, 1897, Pelletan spoke of the 200 families and their dynasties. Shortly before that, on June 10, 1897, the Chamber (*Journal officiel*, pp. 1436 ff. with the vote given on p. 1451) had defeated 405 to 114 Viviani's proposal to nationalize the Bank.

Napoleonic law of 1806. Nominally, it was a private corporation whose shares were actively traded on the bourse. On December 26, 1934, the 182,500 shares were owned by 41,668 shareholders. Only 6,195 of these owned more than five shares each. The powers of the shareholders were vested in the general assembly composed of the 200 French citizens who held the largest number of shares for six months before an election. In 1935 this meant that a person (or corporation) would have to own about 85 shares to qualify for the general assembly. During the boom years a share sold for as much as 25,000 francs, and even in 1935 they were quoted at 10,000 francs. Hence it would take at least 850,000 francs to qualify. Small wonder that membership came to be regarded as a sign of financial importance and that a list of members read something like a social register with counts, dukes, and representatives of the haute finance. Small wonder, too, that they were frequently referred to as the 200 families who govern France.

The chief function of the general assembly was the election of the regents and censors who, together with the governors, composed the general council of the Bank. Of the fifteen regents, three were required to be treasury officials, one an agriculturalist, five to be engaged in manufacture, trade, or commerce. The six remaining regents were, as a matter of fact, bankers. The non-treasury regents were men of large affairs. Francis Delaisi found that these twelve regents held 150 directorships in 95 corporations, including 31 private banks, 8 insurance companies, 9 railroads, 8 shipping concerns, 7 metallurgical, 6 electrical, and 8 mining concerns, 12 chemical industries, and 7 miscellaneous companies.[93] The six banker regents were the élite of the group. Only private bankers of the longest standing came into consideration. Even the Rothschilds were not elected until 1854. Other banker regents represented firms that had been established in Paris early in the eighteenth century. When the head of one of these families died or declined reëlection, he was usually succeeded by the new head of the family. Thus when Baron Mallet requested not to be reëlected in 1860, the Governor of the Bank informed the general assembly that he understood that the baron's son had expressed the wish to succeed his father, and he was elected.[94]

[93] Delaisi, *op. cit.*, pp. 837 ff.
[94] Banque de France, *Assemblée Générale du 26 janvier 1860*, p. 4.

In January 1861, the Governor made a similar speech to nominate Count Pillet-Will to succeed his father, who had died.[95]

The average term of the regents was about fifteen years. Of the 141 men who served from 1800: 30 served 20 years or more; 12 served 30 years or more; 6 served 40 years or more; and 2 served 50 years or more. The tenure of firms was even more impressive. Rothschilds served from 1854, Mirabauds from 1839, Vernes from 1832, Hottingeurs from 1803, and Mallets from the origin in 1800!

It will be recalled that Napoleon revised the law in 1806 to give the government more powers over the Bank. The chief power of the government was the appointment of the Governor and the two deputy-governors. The chief power granted to the Governor was the power of veto. Every contract and engagement of the Bank required his signature; by withholding it, he could veto any transaction of which he disapproved.

But it was now pointed out that the law also required the Governor to own at least one hundred shares of Bank stock. If the nominee was not wealthy enough, he had to borrow some of the money or some of the shares. Chief owners, of course, were the members of the general assembly. It was also pointed out that they were quite willing to lend as long as the governor was a "reasonable" person. Furthermore, the governors who behaved "properly" could look to the regent-controlled Suez Canal Company and the Banque de Paris et des Pays-Bas for remunerative employment should they voluntarily or otherwise leave the employment of the Bank.

All these factors were thoroughly aired in the election campaign.[96] The general workers' confederation (Confederation Generale du Travail) presented a plan on October 6, 1935, which called for the nationalization of the Bank. In its national council of November 16 and 17, 1935, the national confederation of veterans and victims of the war (Confederation nationale des Anciens combattants et victimes de la guerre) adopted a plan for a complete reconstruction of the control and management of the Bank. The plan committee of the socialist party (Parti socialiste de France: Union socialists) also recommended a reorganization to diminish the powers of the "financial oli-

[95] Banque de France, *Assemblée Générale du 31 janvier 1861*, p. 4.

[96] The discussion which follows is based upon the digests of programs of the parties which were published in *L'Europe Nouvelle Documentaire*, No. 30, Supplement to No. 937 of "L'Europe Nouvelle," January 25, 1936.

garchy." The program of the Popular Front (Rassemblement Populaire) recommended: "FAIRE DE LA BANQUE DE FRANCE, aujourd'hui banque privée, LA BANQUE DE LA FRANCE."

As a result of the overwhelming victory of the Popular Front at the polls, the Bank was completely reorganized. It was not nationalized, but the power of the government in the selection of the management was greatly increased. For present purposes the details of the reform may be omitted. The significant factor is that victory at the polls spelled victory over the Bank of France. It might be mentioned, in view of 1806, that a change in the law alone, however fundamental, does not assure permanence to that victory.

THE IMPORTANCE OF PERSONALITIES

No analysis of the relationships between the government and the Bank would be complete without some consideration of the importance of personalities. Incidental reference has been made to this factor already. A few illustrations may be cited where the matter of personalities was of determining importance.

During the siege of Paris both the government and the Bank were run from two centers: Paris and the provinces. To draw a sharp contrast, one might say that whereas the Paris contingent of the government needed bread to feed the besieged inhabitants, the provincial contingent needed money to organize a relieving army.

The Bordeaux, or provincial segment of the Bank was being managed by Deputy-Governor Cuvier, a faithful, unimaginative, timid, formal functionary who had received no instructions from Paris. After he had assumed authority to the extent of lending a hundred millions to the government of the national defense, he was informed by the Paris office to resist all further demands energetically and to forward them to Paris for decision.[97] But communications with Paris became increasingly difficult, and the provincial government needed funds urgently. When the government requested a second loan of a hundred millions at once plus such additional amounts (estimated at ten millions a day) as might be necessary to prosecute the war,[98]

[97] Assemblée nationale, *Enquête parlementaire sur les actes du gouvernement de la défense nationale, Rapport No. 1416 H* (Versailles, 1873), pp. 62–63.
[98] *Ibid.*, p. 66.

Cuvier refused. Gambetta, however, was not one to permit financial difficulties to interfere with the national defense.[99] Persistent and increasing pressure was applied upon Cuvier who could not reconcile further loans to the government with his instructions from and his obligations to the Bank. His answer to each appeal was: "I am not the Bank; it is in Paris."[100] Finally, when Laurier, Minister of the Interior, threatened to form a state bank to issue currency, Cuvier recognized that it might also destroy the Bank. He pleaded that he was only an old functionary, a classic and correct deputy-governor, and that he preferred that the Bank would not receive such a blow from his hands.[101] He was content to wash *his* hands with the request that he be replaced.[102] On December 27, Laurier sent a long despatch to Gambetta. He reported that Cuvier had been replaced by de Villers, one of the treasury regents of the Bank, who had immediately agreed to lend to the government. On the same day de Roussy and Roy wrote Picard in Paris to have the Bank appoint a representative empowered to contract with the government. Since de Villers was busy with other work and since an early reply to the Picard message could not be anticipated, Laurier hoped to find another deputy-governor who would accede to the wishes of the government.[103] M. Roy discussed the position with O'Quin and asked him to accept appointment as deputy-governor. O'Quin conferred with some friends including the three regents of the Bank—all treasury officials—who were not besieged in Paris, and accepted the appointment. At once he entered a contract with de Roussy whereby the Bank agreed to advance such sums as were necessary to prosecute the war until the provincial government was reunited with the government in Paris.[104] Communications were reëstablished with Paris shortly. O'Quin acted without instructions for perhaps a week, but it was an important week. Eventually, the Paris government and Governor Rouland of the Bank substituted a new contract for that of de Roussy and

[99] See his dispatches, *ibid.*, esp. pp. 139, 142.

[100] *Ibid.*, p. 116.

[101] Assemblée nationale, *op. cit.*, *Dépositions*, vol. II, p. 20. To inquiries as to the genuineness of the proposition to create a state bank, a witness (deRoussy) replied that it was more an argument than a project, *op. cit.*, *Rapport No. 1416 H*, p. 74.

[102] *Ibid.*, p. 103, copy of letter of M. Cuvier introduced by M. Roy.

[103] *Ibid.*, pp. 145–146, dispatch Laurier to Gambetta.

[104] *Ibid.*, p. 148.

O'Quin. Cuvier was returned to his position as deputy-governor.

Hardly had this episode passed before the Bank was confronted with the Commune of Paris. The delegates of the Commune demanded funds of the Bank. Governor Rouland yielded. The general council of the Bank agreed on March 22, 1871, that since the Bank could not transport itself to Versailles, as had others, it would have to do all in its power to avoid collision with the Commune. Next morning Rouland turned the administration of the Bank over to de Ploeuch, deputy-governor, and left for Versailles. It is significant to observe that Rouland remained with the government. It is also interesting that when the important decisions of the Bank were being made in Bordeaux, he was in Paris. Now that the scene of importance shifts to Paris, he has gone to Versailles.

The position of de Ploeuch was not easy. He met the first peremptory demands by stalling for time. The Commune sent Charles Beslay to interview de Ploeuch. The latter informed Beslay that if the Bank were attacked, it would defend itself. "But what if the Commune, to avoid bloodshed, should appoint a governor?" asked Beslay. "A governor! No, I shall never accept that. I am the governor of the Bank. I have the sole authority, and force alone will dispossess me," replied de Ploeuch.[105] In the ensuing conversation de Ploeuch and Beslay agreed "to save the Bank for the country."[106] Beslay was convinced that anything (such as the occupation of the Bank by troops of the Commune) which would destroy confidence in the Bank would also be a mortal blow to the currency.[107] Not long after the interview Beslay returned to the Bank with a mandate from the Commune of Paris appointing him delegate to the Bank. As delegate, Beslay on a number of occasions prevented Commune troops from invading the Bank. So effective was he that de Ploeuch later testified that without his aid the Bank would have been destroyed.[108]

On March 18, the city of Paris possessed a credit of over nine million francs at the Bank. Whenever de Ploeuch "could read

[105] Assemblée nationale, *Enquête parlementaire sur l'insurrection du 18 mars, Dépositions*, vol. II (Versailles, 1872), p. 491.

[106] An interesting aftermath is given in Charles Beslay, *Mes souvenirs, 1830, 1848, 1870* (Paris, 1874), pp. 420 ff. It seems not unlikely that Beslay was given at least safe passage to Switzerland as a reward for his efforts.

[107] Beslay, *op. cit.*, pp. 393–430, esp. p. 394.

[108] Assemblée nationale, *op. cit.*, p. 492.

in the eyes"[109] of the delegates that resistance was useless, he would pay from this deposit. In the first days of the Commune he expected early military action from Versailles and did all in his power to gain time.[110] After two or three weeks, when the Commune imagined itself well established as the permanent government, he flattered its representatives by dealing with them calmly and regularly as he would contract with representatives of a regular government. He discussed the difficulties that the Commune might experience if it should attack the Bank—almost everybody held some Bank notes! From the first days of May, however, when it appeared that the Commune was doomed, de Ploeuch hoped that the radical elements would not force the Bank while he anxiously awaited the government troops. In all, de Ploeuch had held the credits extended to the Commune to just over seven million francs in addition to the Paris deposit of over nine millions.

CONCLUSIONS

For well over a century the policy of the Bank of France was usually controlled by representatives of financial firms of long standing. Although they may compete with each other somewhat, they are substantially unified in their views on credit when there is a conflict with the government. Although they have extensive trading and industrial connections, they favor the copy-book virtues of the gold standard, balanced government budgets, and a governmental policy of laissez-faire. They preferred so-called "sound" financial and investment opportunities to the assumption of risks even when the latter seemed to offer larger returns. In short, their position was that of the typical creditor. They always opposed inflationary action. As disorganized governmental finances led to inflations, they gradually gained powerful support from the numerous group of small rentiers. It was not until the Bank followed its restrictive policies *a outrance* that the public discovered that inflations are not the only possible results of monetary policy and that the Bank itself might follow unpopular policies.

The government suffered under two great handicaps: its

[109] Assemblée nationale, *op. cit.*, p. 495.

[110] Assemblée nationale, *op. cit.*, pp. 488, 493, 494, 500. For example, he would refuse, if possible, to grant funds until he could call a meeting of the general council of the Bank to approve.

interests were diversified and it was composed of heterogeneous groups which did not agree upon policy. Whereas the financial groups were interested ultimately in financial policy, the government was interested in many things from time to time: the suffrage, the Dreyfus affair, church and state, form of government, to mention only a few. These diversified interests consumed so much energy that only a little remained to be devoted *continuously* to the Bank. In a measure, the financial groups could control by default. It is significant, in this connection, that only one major Parliamentary inquiry was conducted on the policy of the Bank throughout the nineteenth century (1865–66).

Even when it became interested, the government was not nearly as unified as the financiers on objectives. To maintain a cabinet at all it was necessary to enroll strange banners under a single bloc or front. In 1935 the government simultaneously announced mutually contradictory objectives: an easy money policy and maintenance of the existing gold value of the franc. The *minimum* demands of the groups farthest Left would not be accepted by a majority of the Chamber. But as the prospective premier moved to the Right to establish a majority, he had to appease groups who favored the Bank.

When the issue is sharply drawn between a strong government and the Bank, however, it is the government which wins the victory; the Bank must yield. For this purpose a strong government may be defined as one which has immediately a reliable majority in the legislature and ultimately a reasonably certain majority of votes from the electorate.

But the governmental victories have not been permanent. As the importance of the issue recedes and as other issues acquire prominence, the government gradually loses interest, or it loses its dependable majority. The financial group never loses interest. It is ever alert to reëstablish its power.

BUDGETARY SYMBOLISM AND FISCAL PLANNING

Harvey S. Perloff

SUMMARY

THE *whole question of public budgeting is shrouded in a mist of traditionalism and symbolism to such an extent that it is rarely discussed on the level of governmental techniques and mechanisms. The budget is popularly conceived as being first and foremost an instrument of* control *and* economy, *rather than a tool of government fiscal planning.*

The budget developed in a period when fiscal soundness *was part of the ideal of minimum government interference with the private economy. The various principles of public budgeting, including the demands for economy and efficiency, were rooted in the prevailing social ethic. But in time they became abstract symbols.*

In the face of altered conditions, including the demand for security, the Roosevelt administration has followed a policy of improvisation.

Recent fiscal policy went through several stages: 1) attempts at a balanced budget, 2) regarding of deficits as a necessary evil, the price to be paid for carrying out the essential relief and recovery measures, 3) pump-priming, 4) "compensatory" fiscal policy.

Leaving out the early period, we find that deficit financing became the keystone of fiscal policy, yet there was no tie-up between the federal program and non-federal activities. Federal income-increasing expenditures, which were at a very low level at the depth of the depression, reached their peak during the recovery years of 1935 and 1936.

Neither the institutions nor the fiscal concepts of the period were capable of the rapid readjustments that were necessary. The successful application of a counter-cycle fiscal policy requires careful planning of a coördinated program at all levels of government and a long-term point of view. There is need for a flexible and efficient machinery for such planning. The budget is clearly the instrument most suited to such a task. The criterion for judging budgetary techniques and procedures must be the degree to which they aid in successfully planning and carrying out governmental fiscal programs.

Once it is clear that fiscal soundness cannot be an absolute concept, but must depend upon individual political decision, it becomes equally clear that budgetary policy cannot logically be geared to the financial programs adopted in the fulfillment of the basic political decision. The

budget, then, can serve financial soundness best by aiding the successful planning and execution of fiscal policy, and by introducing regularity and system into government finance.

THE EDITORS

POPULAR BUDGETARY CONCEPTIONS

It would be asking the impossible to expect the general public to grasp the intricacies and economic refinements of governmental fiscal activity. And because the budget stands as the only summary statement of all national financial policy, it is taken as a broad criterion for passing judgment upon the activities of government in the general field of fiscal relationships. As is to be expected, budgetary judgments are based upon oversimplified, symbolic ideals. This often leads to a popular distortion of fiscal realities. Special interests can be relied upon to use such distortion to their own particular ends. At certain times this merely amounts to a siphoning of public funds in one direction rather than in another. At other times, however, fiscal perversions may present necessary adjustment to social changes, with serious consequences for the national welfare.

Certain students of American government finance have been content with pointing out the irrationalities of fiscal activities. The formulation of fiscal policy, they conclude, represents a compromise between powerful economic forces in the community. The whole thing is nothing more or less than the play of pressure groups seeking to benefit at the expense of others. Although political reality demands a full understanding of this process, however, we cannot leave the matter at this stage if we are at all concerned with its implications for the general welfare (or whatever we wish to term that elusive something which is supposed to be guaranteed by the democratic process).

It must be clear that the use of public funds is the centrifugal force of collective action. Alexander Hamilton eloquently epitomized this basic fact in the *Federalist:* "Money is, with propriety, considered as the vital principle of the body politic: as that which sustains the life and motion, and enables it to perform its most essential functions." But if the *motion* of the *body politic* is to be steady and progressive, and in time with the movement of social change, then fiscal policy and the finan-

cial machinery of government must necessarily keep pace with the demands made upon them.

Unfortunately, we find certain forces of inertia converging with particular intensity to hamper adjustments to new fiscal situations and new communal needs. For one thing, certain groups in the community see in the financial machinery of government an essential balance wheel of the existing social order. They resist any changes in that mechanism on the ground that it will unbalance the social structure.[1] For another, certain symbols and traditions in the fiscal realm have become what amount to popular creeds demanding unquestioning faith. Since the budget is the focal point of government financial activity (from the standpoint of publicity and popular comprehension), it has been particularly subject to this phenomenon. The whole question of public budgeting is shrouded in a mist of traditionalism and symbolism to such an extent that it is rarely discussed at the level of governmental techniques and mechanisms.

The budget is the crucible into which the manifold issues of collective action, economic intervention, tax justice, economy, pressure groups, and so on, are dumped pell-mell and molded into a common shape—monetary figures. Thus, the whole activity called "governmental spending" can be treated as an abstract concept and closely associated with the words "recklessness" and "extravagance." The resulting color of the admixture—i.e., whether it is red or black—can be used as a final criterion for judging the "soundness" of an administration. An increase in taxes can be talked of as a drain on the private economy—even though such taxes may be used to finance subsidies to certain sections of the economy and to bring about a distribution of economic goods that actually promotes productivity. Generally, the basis of judgment is an emotional reaction to certain abstract concepts. Recent Gallup and *Fortune* polls, for example, reflected a large majority opinion against *spending* in general by the government.[2] But when it came

[1] Typical of this reaction is the criticism of the Roosevelt administration by the American Liberty League, because, among other things, "the New Deal has prostituted the taxing power under the constitution to accomplish social and economic ends remote from the raising of revenue." From a statement made public July 19, 1936, as reported by the *New York Times*.

[2] The American Institute of Public Opinion poll was taken in April, 1938, that of *Fortune*, in March, 1939. Similarly, a study of the press reaction to the President's suggestion, in the spring of 1938, for a new program of spending revealed

down to specific items, there were majorities of 81 per cent against reducing expenditures for armament, 82 per cent were in favor of an adequate old-age pension, and 86 per cent favored a continuation of farm benefits. Similarly, a majority were for work relief in preference to the dole, notwithstanding the fact that work relief is far more expensive. The only place where any sort of general agreement for reduction could be reached was in the ordinary operating expenses of the government. But here again we have a non-specific item which can be discussed vaguely in terms of "administrative economy," "bureaucracy," etc.

Not only is *the budget* the dumping-ground for a variety of broad issues, but it is popularly conceived as being first and foremost an instrument of control and economy, rather than a tool of government fiscal planning. Thus, a departure from "sound economy" is viewed as a misuse of the budget and a danger to democratic control. D. T. Smith, for example, writes: "There is a real and very great danger that a democracy may spend itself to death, as it were, once it departs from a balanced budget."[3]

In totalitarian countries there is, of course, no such problem. Government budgeting is nothing more or less than fiscal planning aimed directly at the achievement of the objectives of the ruling clique. In the United States, on the other hand, *the budget* is an intermixture of many ingredients: a statement of expenditures, revenues and debts, a document presented by the executive to Congress, a series of legislative measures, a political program, an instrument essential to democratic governments, a tool to enforce economy—as well as a planned financial program. All these ingredients are by no means given equal weight. The role of the budget in the social structure is conceived chiefly in terms of popular control and governmental economy. Such a conception derives directly from the traditional and symbolic elements which have attended the evolution of our modern philosophy of public budgeting.

The basic pattern of this development is not far different from that which has molded others of our beliefs and concepts. In

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that for every editorial and dispatch in favor of the program, there were six against it. Burt M. McConnell, "The Press Looks at Pump-priming," *Current History*, vol. 48 (June 1938), pp. 30 ff.

[3] *Deficits and Depressions* (New York, 1936), p. 179.

the search for techniques and institutions to fulfill the social needs, "fundamental principles" are evolved. They constitute in part an ideal to be aimed at, and in part a justification of the existing structures and beliefs. As the institutions mature and the beliefs become traditional, the principles begin to be conceived as universal truths and in time they become creeds demanding unquestioning faith.

BUDGETARY TRADITIONS

Important to the development of our philosophy of governmental budgeting is the fact that the budget evolved as an instrument and symbol of the democratic, laissez-faire ideal.

The seeds of modern budgeting lie in the struggle over the power of the purse. Born in a period when this power was jealously guarded against the demands of royal prerogative, public budgeting reached its maturity in a later period, when "sovereign" peoples sought to safeguard the fruits of a hard-won victory. To the new classes seeking power it was clear that "he who controls the finances of the state controls the nation's policy." From popular consent to taxation, to parliamentary approval of expenditures through appropriations, to the periodic discussion by the legislature of expenditures and revenues set up in the form of a financial plan—these are the logical stages in the evolution of government by representatives of the people.[4]

It is natural that the budget, as the focal point of financial, and therefore of governmental activity, should have developed as a powerful instrument of popular control. Thinking about the budget was constantly in terms of the democratic ideal. To perfect the budget, to improve budgetary procedures, was to perfect and improve democracy. H. C. Adams well expressed the typical attitude when he wrote:

> The comprehensive nature of budgets . . . is not suggested by regarding them either as a report or as a project of law: they must be conceived as a part of the political machinery essential to the realization of the ideal of popular government before their dignity and importance can be adequately appreciated.[5]

[4] For an account of this development, see Gaston Jèze, *Théorie Générale du Budget* (Paris, 1922), pp. 10 ff. Also F. W. Maitland, *The Constitutional History of England* (Cambridge, England, 1920), and Charles A. Beard, Introduction to René Stourm, *The Budget* (American translation, New York, 1917).

[5] Henry Carter Adams, *The Science of Finance* (New York, 1898), p. 105.

From England, the United States inherited a whole set of financial techniques and traditions aimed at preventing arbitrary executive power.[6] But when the people resorted to the legislature as the palladium of democracy, new problems of control arose. For, with time, the spending of public moneys became not so much a question of social necessity as of party politics. Congress became "the happy hunting ground" and "pork barrel" appropriations were voted with machine-like precision.[7]

In the campaign for the reform of governmental abuses and inefficiency, the budget became a keystone about which were centered the demands for economy and efficiency, for freedom from graft and corruption. It was a blazing symbol—the rallying ground for reform.[8] When the movement gathered momentum *the budget* became a campaign issue and party managers "set their sails to catch the favoring wind in the hope that it would waft their chosen candidates into office."

The campaign for budget reform was successful, climaxed by the passage of the federal budget law, under the title of the "National Budget and Accounting Act," in June of 1921. The emphasis throughout had been on control and economy, and the budgetary techniques which were developed were aimed in that direction. Thus, regular meetings of "the responsible representatives of the business organization of the Government" became an integral part of the budget process. These meetings were directed at financial economies, as were the One- and Two-Per Cent Clubs, the Bureaus of Efficiency and the Coördinating Boards. The fetish for economy extended to the Budget Bureau itself. Its staff and expenses were extremely

[6] For a discussion of colonial struggles for the right to control the purse, see Charles J. Bullock, "The Finances of the United States from 1775 to 1789 with Especial Reference to the Budget," *Bulletin of the University of Wisconsin*, vol. 1 (June, 1895), pp. 117–273.

[7] The 1916 *Annual Report of the Secretary of the Treasury* is illuminating on this point. Representative of the legislative attitude toward expenditures is the classic remark of Senator Tillman of South Carolina: "The whole scheme of river improvement is a humbug and a steal; but if you are going to steal, let us divide it out, and not go on complaining." *Congressional Record*, March 4, 1901, p. 3906.

[8] Frederick A. Cleveland, writing in 1915, rejoiced in the fact that "the 'budget idea' has finally come to be thought of as a constitutional principle—one which has been used effectively for the purpose of developing representative government and keeping it in harmony with the highest ideals of democracy." "Evolution of the Budget Idea in the United States," *Annals, American Academy of Political and Social Science*, vol. 62 (November, 1915), p. 15.

limited—but so were its scope and achievement. It more than had its hands full in examining the requests of the spending agencies, relying almost completely upon previous expenditure records. A careful and detailed examination of the various government activities and the relative justifications for spending public moneys were out of the question. Thus was the association of the budget with strict governmental economy carried to its illogical conclusion.

But other factors also played a role in the development of our philosophy of public budgeting. For together with the growth of democratic government had come a new ruling class and a new economic pattern of life. "Sound" governmental financial policy was interpreted as calling for a limitation of public activities and expenditures to a minimum, and for a minimum disturbance of the pricing system. It was felt, quite generally, that social needs would best be fulfilled if private enterprise was left free to pursue its own ends; that government interference was, on the whole, harmful; that the abstraction of funds from the private economy by the government was undesirable.

It was from this background that certain budgetary principles were evolved as guides for statesmen and as bases for judging the soundness of government fiscal activities—"soundness" being conceived as adherence to the prevailing laissez-faire, democratic ideal.

Thus, the principle of *Budgetary Equilibrium* (which insists on a balance between all government expenditures and current revenues) was evolved, in the final analysis, as a demand that the state keep within its immediate means—for therein lies the assurance that the government will not indulge in reckless spending, that it will not expand its activities too quickly, and that it will not divert more funds from the private economy than it can obtain by the difficult and painful process of taxation. Since government borrowing enables a rapid expansion of public enterprise, it was alien to the ideals of a business civilization.[9]

From the principle that "revenues of a determined and short period were the best guarantee of the frequent convening of Parliaments" evolved the budgetary canon of *Annuality*. It

[9] For a typical interpretation of budget balancing, see Fritz Neumark, *Der Reichshaushaltplan—Ein Beitrag zur Lehre vom offentlichen Haushalt* (Jena, 1929).

was generally agreed that: "A year seems to be the maximum of time over which legislatures can afford to give the power (control of the purse) out of their hands. . . ."[10] But beyond guaranteeing the frequent convening of legislatures, the rule of annuality was to aid in maintaining "sound" financial practices by insisting that revenues and expenditure should *balance year by year*. This, Hilton Young called "the golden rule of economy."[11] The "economy" which this rule demands is clearly that of preventing capital funds from passing out of the private economy into the public field. It leaves no scope for government borrowing (beyond short-term borrowing in anticipation of taxes), and thereby imposes a very real limit on the expansion of governmental activities.

Again, the rule of *Unity* came to be considered an essential of "good" budgeting. It was a demand that all fiscal material be presented in a single budget, that there be no segregation within the budget system. "Budgetary unity," insisted Jèze, "is, for Parliament, the best means of *control* and comparison. . . ."[12] Infraction of unity—through the use of so-called "extraordinary" or "emergency" budgets—was conceived as implying a desire on the part of the government to conceal an increase in expenditures by dividing their totals and to justify unnecessarily large expenditures by characterizing them as of a unique vintage. "This, in reality," wrote Stourm, "is always the purpose underlying the separation of the extraordinary budgets: they are made to delude the country." This departure from "sound" finance was taboo, however, mainly because it generally involved government borrowing and thereby enabled the state to spend beyond the limits of its current revenue.

Similarly, each of the other canons of public budgeting had a *raison d'être* in terms of the prevailing social ethic. Back of the principles of comprehensiveness, publicity, prior authorization, specification, etc., stands a long history of bitter struggles against oppressive executive authority and against irresponsible representatives; a history marked by the rise to power of a class which assigned to the state a limited and purely protective role, and which imposed upon the state the methods and ideals of the civilization it evolved.

[10] René Stourm, *op. cit.*, p. 319.
[11] *The System of National Finance* (London, 1915), p. 11.
[12] Gaston Jèze, *Théorie Générale du Budget* (Paris, 1922), p. 198.

So universal was the ratification of these rules of public budgeting, and so honorable their history, that society in time forgot their *raison d'être* and accepted them as a final good. They became social symbols and, as such, have persisted until the present day. The result has been the perpetuation of a philosophy of governmental budgeting which arose as a rationalization of a social order, as a distillation of experience in a particular era.

POLITICAL AND ECONOMIC CHANGES

Certain it is that many changes have come about since the principles were first formulated, both in political and economic structures and in social concepts and ideals.

For one thing, the state has been called upon by the demands of a large section of the community, and by the sheer necessity of overwhelming social needs, to take a more active part in the social process. It has been called upon to bring about a more equitable distribution of wealth, to regularize employment and care for the unemployed, to control industries charged with a plain public interest, to prevent the private economy from breaking down under the weight of too severe crises—in short, to take a more active part in society's attempt to achieve security and the more abundant life.

Moreover, the conditions of the economy have vastly altered (at least from what laissez-faire, competitive theory would have it). We are now faced with an economy in which competition is not "free," allocation of resources is not subject to the pricing system alone, equilibrium is not the necessary rule, and factors of production are not fully utilized. Under such circumstances the role of the public economy in relation to the private economy is certain to undergo vast changes. The fate of the economy is left less in the hands of "natural law," and more emphasis is placed on human organization.

With these developments, the fiscal machinery of government has had to be utilized for purposes far beyond the financing of the so-called "traditional" government services. For quite some time, the fiscal machine has been employed to accomplish far-reaching social ends, such as the prohibition or discouragement of certain activities regarded as undesirable, the more equitable distribution of income, the expansion of collective consumption, and the raising of the national standard

of living. But although severe and ever-recurring depressions have long since saddled governments with many social problems, the promotion of stability and security was, until quite recently, considered beyond the scope of state activity. Complete reliance was placed on what was thought to be the automatic, self-regulatory mechanism of capitalism.

During the last generation, however, a tremendous change has taken place. Stability and security have become inescapable governmental problems. The "invisible hand" has been entirely discarded in favor of direct control in nations under a dictatorial régime. But even in the democracies the management of the business cycle has become a public function in the face of the social hazards of instability and unemployment.

"NEW WINE IN OLD BOTTLES"

Governing groups can be expected to attempt a solution of at least the more immediate problems in periods of social stress, since popular discontent will clearly threaten their political existence. This is a factor which transcends even the force of diverse pressures and ideologies.

Thus, in the face of an unprecedented crisis, government spending on a large scale was undertaken by both the Hoover and Roosevelt administrations. "Shock funds" had to be thrown promptly into the breaches in the social and business structures. Demands for overcoming individual and institutional distress took precedence over demands for a balanced budget.

This phenomenon occurred everywhere. Studies by League of Nations experts[13] and Hugh Dalton and his associates[14] revealed that almost every national unit of any importance incurred at least one deficit during the last depression, and some experienced a continuous series of unbalanced budgets. Quite generally it was discovered that accepted fiscal notions were far removed from concrete realities. But only in one or two isolated cases was a concerted effort made to construct "a new scheme of legal and institutional regulations for the fiscal house-

[13] League of Nations, Economic Intelligence Service, *Public Finance, 1928-35* (Geneva, 1936).

[14] Hugh Dalton and others, *Unbalanced Budgets—A Study of the Financial Crisis in Fifteen Countries* (London, 1934).

hold."[15] Rather, governments tended to follow a policy of improvisation and to turn to "the window dressing ingenuities of public accounting."

Such was the course taken by the federal government. Through a dual bookkeeping arrangement—based on the principle of a balanced "regular" budget, which is made to balance by setting up a separate "emergency" category—the administration kowtowed to the principle and avoided the fact. Furthermore, to escape the strait-jacket of traditional federal finance, the government felt it necessary to create numerous independent agencies with power to obtain their own funds, and to indulge in all sorts of financial contortions (as exemplified by the purchase of Home Owners Loan Corporation stock by the Treasury with funds provided by the R.F.C., which in turn had obtained its capital by sale of its notes to the Treasury). It was impossible, under such circumstances, for anyone, including Congress, to get a clear picture of what was going on.

The fiscal record of recent years has revealed only too clearly the manner in which budgetary traditionalism and symbolic concepts stood in the way of permitting the budgetary mechanism to be employed as an instrument in the planning and execution of the economic and social policies of the government. During a period in which revolutionary developments have been taking place in government finance as well as in the relationship of the state to the private economy, the administration has felt itself called upon to justify its actions in terms of principles which quite clearly have very limited application. Furthermore because of the traditional view of our federal budget as an instrument of control and economy, the budgetary mechanism has not served the needs of fiscal planning nor of revealing, in the more fundamental aspects, the results of current fiscal policy.

When the Roosevelt administration came into office in 1933, a serious attempt was made to balance the budget along traditional lines.[16] Yet, at the same time, the administration became

[15] See Gunnar Myrdal, "Fiscal Policy in the Business Cycle," *American Economic Review*, vol. 29 (March, 1939, Supplement) pp. 183–193. Reprinted with permission of the *Review*. Also "That Wonderful Swedish Budget," *Fortune*, vol. 18 (September, 1938), pp. 65 ff.

[16] There was a general conviction that the government's credit would suffer if the budget was not promptly balanced and that economic recovery depended on

convinced that the crisis conditions called for huge emergency expenditures. For some time there was an attempt to maintain that there was economic merit both in curtailing ordinary and in expanding extraordinary expenditures. Politically minded and fully aware of the popular conceptions concerning large government spending and budget balancing, Mr. Roosevelt constantly and publicly stressed the "emergency" character of the new expenditures and continued to make gestures towards a balanced budget.

Since governmental action must have a philosophical justification simplified into an acceptable symbol, the administration held out to the public the similarity of depression and war finance. It was a war against depression. Just as victory in battle was contingent on a huge public debt, so was recovery. The emergency expenditures engendered by an economic crisis should not be viewed in the same light as the regular outlays of the government. Under such circumstances, we should not seek a balance between current income and all expenditure; a balance between current income and "ordinary" expenditure is all that is necessary to assure sound government finance.

The introduction of what was generally termed an "extraordinary budget" aroused a storm of protest and was severely criticized in many quarters. ("*We have two budgets but only one Treasury.*") The administration was accused of trying to deceive the public, of indulging in unsound fiscal practices and in extravagance on a monumental scale. Others came to the defense of the government and urged that the segregation of emergency from other expenditures was justified under the circumstances.[17] The debate over the *extraordinary budget* was clearly superficial and symbolistic; the issue, obviously, was not the form of the budget document, but the advisability, at the time, of a government spending program based largely on borrowing. Those who felt that business stability and the government's credit were seriously threatened by the huge deficits did not have their fears allayed by the balancing of a budget which "does not include any additional expenditures for extra-

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an immediate balance. The legislation enacted at the request of the President was entitled "an Act to Maintain the Credit of the United States Government." The rate of pay of government employees was cut 15 per cent, veterans' benefits were reduced, and taxes were increased.

[17] See, for example, J. Wilner Sundelson, "The Emergency Budget of the Federal Government," *American Economic Review*, vol. 24 (March, 1934), pp. 53–68.

ordinary purposes."[18] On the other hand, those who shared with President Roosevelt the view that the emergency situation called for large government expenditures and that "the immeasurable benefits justify the cost," agreed that the incurring of deficits in the financing of such emergency outlays was completely justified.

CHANGES IN FISCAL POLICY

This "emergency" period marked, on the part of the administration, a new conception of the role of fiscal policy. In the face of unemployment and business stagnation, it was felt, the government could not afford to sit back and wait for a "normal" recovery. It must take positive financial action to alleviate suffering and bring about a rapid business recovery.[19]

For some time government deficits were looked upon as a necessary evil—the price to be paid for carrying out the essential relief and recovery measures. It was felt that a return to a balanced budget must be made as soon as it was humanly possible. The administration came, in time, however, to view deficits in an entirely different light. It had discovered that there was at hand a better justification of huge government expenditures than that of sheer "emergency" necessity. Certain eminent economists were urging that vast governmental disbursements were the primary requisite for recovery. Interest in the so-called "pump-priming" theory reached its peak at the time of Keynes' visit to America in the spring of 1934. It was at about this time, it has been suggested, that the administration shifted to the view that large government deficits, far from being an evil, were a virtue in time of depression. During the "emergency" period, expenditures and deficits had been mounting; the government had been just swimming along, going with

[18] In his budget message presented January 3, 1934, President Roosevelt had declared that with the exception of debt retirement, the budget estimates for the fiscal year 1935 show a small surplus, but that this budget "does not include any additional expenditure for extraordinary purposes."

[19] The relief and recovery measures taken at that time included:

(1) provisions for relief of the unemployed and destitute;
(2) extension of financial aid to, and underwriting the credit of, distressed economic institutions and groups; and
(3) stimulation of employment and purchasing power by means of the National Recovery Administration, extensive appropriations for public works, and the restoration of agricultural purchasing power through benefit payments and other devices provided by the Agricultural Adjustment Administration.

the current. Now it was beginning to defend and rationalize the process.

The pump-priming view held that the so-called natural forces could not be relied upon, in the existing situation, to counteract the powerful deflationary forces at work, nor to bring about recovery. Furthermore, even if a "natural" recovery should come in the course of time, the social cost involved in the continued non-utilization of the community's human and physical resources was too high a price to pay. Government expenditures would supply the missing spark; they would prime the industrial pump. And, moreover, a given amount of public spending would have an effect upon the national income far in excess of the actual volume of expenditures made. Since the purpose of the government spending is to compensate for the deficiencies of private spending, the funds must come, not from taxation, but from borrowing. Taxation might merely divert money which would have been spent anyway; the spending of borrowed money is a net gain, since during a depression there is a large amount of idle funds at hand. Consequently, a deficit becomes, not an evil, but a primary requisite for recovery. But such deficit spending in depression must be offset by surplus financing during subsequent prosperity. This means that annual budget balancing must be abandoned in favor of a policy of balancing expenditures and revenues over the period of the business cycle.

By the end of 1934 the administration had accepted the doctrine of the advisability of balancing the budget over the complete cycle. The best way to achieve a balanced budget was to continue heavy outlays until such time as economic recovery should permit revenues to catch up with expenditures. This view was expressed by President Roosevelt in his budget message of January 3, 1936: "Secure in the knowledge that steadily decreasing deficits will turn in time into steadily increasing surpluses, and that it is the deficit of today which is making possible the surplus of tomorrow, let us pursue the course that we have mapped."

Having accepted the doctrine of priming the pump through the medium of large government outlays, the administration vigorously pursued a policy of public spending and deficit financing. Those sections of the relief and recovery program which were found to be slow in developing and comparatively

small in magnitude were scrapped and new instrumentalities for disbursing public funds were established. Thus the FERA program of federal grants to the states was liquidated and the federal works program instituted. It was felt that only by greatly accelerating the volume and speed of government disbursements could processes of real recovery be generated.

A good deal of confidence as to the effectiveness of deficit financing was expressed during the economic recovery of 1935–36. Many held the view that at last an instrument had been found for controlling the fluctuations of the business cycle. With the serious "recession" of 1937, however, grave doubts began to be expressed as to the ability of the government to prime the industrial pump. For some, the course of events seemed to lead to the conclusion that deficit spending cannot itself start a revival of such a sort that it can go on under its own power after the stimulus of deficit financing has been removed. More emphasis was placed on the "compensatory" aspects of government spending. "Such spending may be a stimulus to production, which may be self-multiplying to some extent but not to any significant extent self-perpetuating. In this aspect it may be useful to tide over a depression until other forces initiate a self-sustaining revival."[20]

The "compensatory" viewpoint seemed to have been accepted by the administration. The ideal of balancing the budget in the near future appeared to have been abandoned. In its place was the suggestion that the balance was destined eventually to appear whenever the national income should have grown to the requisite amount. Until that point, the President urged, government spending would be necessary to compensate for the lack of sufficient private spending. The budget message of January 3, 1939, presented estimates of the revenues that the existing federal tax system would produce at various levels of national income.[21] The inference seemed to be that if we should succeed in attaining a high level of national income, the budget problem would be solved more or less automatically.

[20] J. M. Clark, "An Appraisal of the Workability of Compensatory Devices," *The American Economic Review*, vol. 29 (March, 1939, Supplement), pp. 199–200.

[21] Whereas the national income today is in the neighborhood of sixty billion dollars, the President suggested, an increase to seventy billion dollars would result in a national revenue of six billions; with a national income of eighty billions the revenue would be eight billions; ninety billion dollars of national income would contribute ten and six-tenths billion dollars of revenue to the national government.

The inference was, further, that the major concern of the government should not be budget-balancing but the raising of the national income to a sufficiently high level. The President, in his budget message, declared: "We cannot by a simple legislative act raise the level of the national income, but our experience in the last few years has amply demonstrated that through wise fiscal policies and other acts of government we can do much to stimulate it."

FAILURE TO APPLY AND COÖRDINATE THE FISCAL PROGRAM

On the basis both of its declarations and its actions it would seem that the Roosevelt administration had accepted deficit financing as the keystone of its fiscal policy and as an important agent for effecting economic stabilization. Let us note to what extent such a program was actually carried out from the standpoint of a logical application of the principles of deficit financing.

It is true that a concerted effort was made by the federal government to push a vast amount of money directly into the income stream. But while federal expenditures and deficits increased rapidly, those of the state and local governments remained at about the same level that they were in 1933. There was no tie-up between the federal program and non-federal activities, even though it was obvious that an expansionist program could have significance only in relation to the total amount of governmental deficit financing.

TABLE 1

GOVERNMENTAL EXPENDITURES AND GROSS DEBT, FISCAL YEARS, 1933–1937
(in millions of dollars)

Fiscal Year	Expenditures			Gross Debt		
	Total	Federal	State & Local	Total	Federal	State & Local
1933	11,284	3,793	7,491	42,056	22,539	19,517
1934	13.604	5,947	7,657	42,876	27,053	18,823
1935	15,011	6,933	8,078	47,673	28,701	18,972
1936	17,009	8,611	8,398	52,757	33,545	19,212
1937	17,187	8,386	8,801	55,579	36,427	19,152

Source: *Conference Board Economic Record*, September 15, 1939.

From the standpoint of pump-priming policy, the important thing is the net addition to the spending power of the community.[22]

Various methods have been employed to measure the net flow of income directly attributed to government activity. But they all show the same thing—that federal income-increasing expenditures, which were at a very low level at the depths of the depression, reached their peak during the recovery years of 1935 and 1936, and were not tapered off until 1937. At the same time state and local governments were making net deductions from the disposable cash income of the community.

TABLE 2

GOVERNMENTAL INCOME-INCREASING EXPENDITURES AND NATIONAL INCOME PRODUCED, CALENDAR YEARS, 1933–1937

(in millions of dollars)

Calendar Year	National Income Produced[a]	Net Income-Increasing Expenditures[b]	
		Federal	State & Local
1933	42,256	1,928	—690
1934	50,052	3,428	—1,159
1935	55,186	3,730	—493
1936	63,466	4,337	—398
1937	68,817	1,092	—291

[a] Estimates of the Bureau of Foreign and Domestic Commerce.
[b] Estimates of Lauchlin Currie: Statement submitted to the Temporary National Economic Committee.

There are several possible explanations of why federal income-increasing expenditures were at a high level during the recovery years of 1935–36. One reason which has been presented is that it was a direct outcome of certain political phenomena, which, in fact, make impossible the application of the pump-priming theory in a democracy. Whereas a full acceptance of a pump-priming policy implies the willingness, and the ability, to run counter to the cycle not only on the down-

[22] Arthur D. Gayer, "Fiscal Policies," *American Economic Review*, vol. 28 (March, 1938, Supplement), p. 98. The above figures of total expenditures and debt are not satisfactory measures of the government contribution to community income. It is apparent that not all government expenditures lead to an increase in buying. "Liquidating expenditures," for instance, i.e., those expenditures which are used to repay debt, may serve a useful purpose in preventing forced liquidation, but do not result in a direct increase in the expenditures of the public. And, of course, when the government spends money that is collected in taxes and would have otherwise been spent by the tax-payer, there is a mere transfer of buying power rather than a net increase.

swing, but also on the upswing, in a democracy—and especially in the United States—political institutions and traditions make a rapid revision of expenditures and taxes on that pattern impossible. A decrease in the level of expenditures is a heroic task; specific suggestions for economies invariably meet with overpowering opposition. At the same time, a rapid increase in taxation is politically unpopular. The conclusion is, many have claimed, that the second part of the pump-priming theory cannot be applied.

Another explanation, and one which has been urged by a good many government officials as well as economists, is that the degree of recovery which was being achieved in 1935 and 1936 did not justify the contraction of federal income-increasing expenditures. Many millions were still unemployed and business had not yet taken up the slack. This meant either that the pump had not been sufficiently primed or that the government outlays could not be depended upon to set the economy in full motion and were merely filling a gap left by business. In either case, this school of thought holds, it was necessary to keep pumping funds into the income stream. On the other hand, it has been suggested that if the government had tapered off its expenditures early in the recovery, the private economy could have forged ahead on its own steam. A conclusion as to whether or not the administration actually followed the dictates of the pump-priming theory can be arrived at, it would seem, only on the basis of the criterion of recovery which is used. If recovery is defined as a period in which the number of unemployed has

TABLE 3
PUBLIC CONSTRUCTION AND MAINTENANCE, 1929–1938
(in millions of dollars)

Year	Total Public	Federal	Non-federal
1929	3,309	357	2,952
1930	3,733	445	3,288
1931	3,424	540	2,884
1932	2,539	576	1,963
1933	1,918	693	1,225
1934	2,474	1,095	1,379
1935	2,548	1,214	1,335
1936	3,496	2,029	1,467
1937	3,329	1,778	1,551
1938	3,711	2,036	1,675

Source: *National Resources Committee Estimates*, prepared for the Temporary National Economic Committee.

reached a low level, then a case can be made out for the justification, under the dictates of the pump-priming theory, of the government's action in 1935–36. If, however, the criterion is a general improvement in business sufficient to show that the economy was on the upswing of the cycle, then it would seem that the administration failed to follow the second part of the pump-priming theory.

Conclusions as to other aspects of the Roosevelt recovery program are much less controversial and point to a definite failure on the part of the government to tie all the elements of its program into a consistent whole.

Contrary to the hopes of those who looked to public works as a primary factor in the stabilization of the business cycle, governmental construction, far from following a counter-cycle movement, followed the course of business prosperity.

Similarly, the developments in the tax structure of the country have not followed the dictates of the counter-cycle theory, which urges an increase in the "propensity to consume" during depression.[23] On the contrary, the depression brought a sharp

TABLE 4

DIRECT AND INDIRECT TAXES OF THE FEDERAL GOVERNMENT: 1928 AND 1933–38

(in millions of dollars)

Type of Tax	1928	1933	1934	1935	1936	1937	1938
Direct Taxes							
Individual Income	883	353	419	527	674	1,092	1,189
Corporate Income	1,292	394	397	572	738	1,057	1,145
Estate	60	31	104	140	219	282	382
Total	2,235	778	920	1,239	1,632	2,431	2,716
Indirect Taxes							
Tobacco	396	403	425	459	501	552	568
Liquor	15	8	259	411	505	594	568
Customs	571	253	316	347	389	490	360
Gasoline		125	203	161	177	196	204
Mfrs. Excise	52	123	187	181	205	353	213
Total	1,034	912	1,390	1,559	1,777	2,185	1,913

Sources: *Annual Reports of the Secretary of the Treasury; Statistical Abstracts of the United States.*

[23] The phrase "the propensity to consume" (as devised by Keynes) refers to the proportion of income which the public is prepared to spend on consumption purchases at various income levels. Under the dictates of the pump-priming theory, the tax structure should be designed to increase the propensity to consume.

rise in the proportion of total revenue raised from indirect taxes weighing on consumption in contrast with the direct taxes applicable to individual and corporate income. Sales taxes came into prominence, as did other taxes weighing on mass consumption. The social security taxes greatly strengthened the general tendency. For the federal government, this was in sharp contrast to the type of tax structure existing during the prosperity era.

All the evidence would seem to point to the conclusion that insufficient attention was given to the effects of the tax structure upon full employment in general, and upon the immediate recovery problem in particular. It would seem that the question of taxes on consumption versus taxes on savings did not receive the attention it deserves as an essential aspect of fiscal policy. Only to a small extent were attempts made to use the tax structure as a regulator of the consumption-saving-investment mechanism. Among these was the attempt to discourage, through taxation, the accumulation of large undistributed reserves, but this proved to be a heavy-handed remedy with unlooked-for repercussions.

WHY FAILURE?

One cannot escape, of course, from the fact that many difficulties stood in the way of successfully translating the counter-cycle theory into a coördinated program. One was the lack of unification in the political set-up. The activities of state and local governments, tended to run counter to the recovery program of the federal government. Another difficulty was the interference with the program by uncontrollable political developments. Such were the invalidating of the processing taxes by the Supreme Court, and the approval by Congress, over presidential veto, of the immediate payment of the veterans' "bonus." Again, there was the ever-present influence of special pressure groups to prevent the logical and coordinated execution of fiscal policy. To note the furor which arose in the Senate when the administration attempted to reduce loans on cotton is to realize that political feasibility, and not only economic soundness, has shaped the course of recovery policies as well as of other democratic programs.

Possibly our governmental set-up is not at all designed for

the direction of deficit financing and we must agree with Haig that: "Perhaps, before deficit financing can be made safe for democracy, democracy will have to improve its mechanism so that action will be less influenced by the shortsighted and immediate special interests."[24]

It may be argued, of course, that the counter-cycle theory was something which existed, in reality, only on the plane of academic discussion, and was used by the administration merely to justify huge expenditures which arose in the main from aims far removed from the promotion of economic stability.

But even assuming sincere intentions on the part of the administration, it may well be asked whether a coördinated and effective program could possibly have been carried out. In face of the apparent dangers of instability and unemployment and the ever-present threat of serious economic crisis, such a question has very real significance for public policy. The answer must clearly be in the negative. The fiscal policy which was adopted was a revolutionary departure from traditional federal financial programs. But neither the institutions nor the fiscal concepts of the period were capable of the rapid readjustments that were obviously necessary.

Any attempt at a change of a social pattern must reckon with long-standing traditions and accepted symbols. This principle is on the one hand the balance wheel of social organization and on the other hand one of its greatest elements of rigidity. The social needs were felt by everyone, but the new slogans which were offered had a queer sound. A *New York Times* editorial of December 27, 1938, well expressed the spirit behind the traditional fiscal point of view:

> There is one objective standard that everyone understands clearly—Federal budgets 'annually balanced.' Once we depart from that, except under the sheerest necessity, we are adrift on the seas of confusion, for all sorts of ingenious reasons are invented for not going back, and the vested interest in favor of keeping the new situation is enormous.

This paragraph is worthy of careful note. What is wanted, in the first place, is an objective standard which can be clearly understood. The administration was in no position to furnish

[24] Robert Murray Haig, "Facing the Deficit," *Yale Review*, vol. 25 (Summer, 1936), p. 693.

such a standard; it was groping its way through unexplored regions. An objective standard cannot be evolved until the goal is clear and steadfast. But, we may ask, is the fiscal criterion the one upon which we can judge a new course of government action? Changes in the institutional structure which are desirable from one point of view may be questionable from another. Of course, "the vested interest in favor of keeping the new situation is enormous." But what of the vested interest in favor of keeping the old? A thoroughgoing change in fiscal policy is certain to engender change in the nature of property relations. Is the financial machinery of government, then, to be geared to the preservation of the status quo? Clearly the nature of our democratic institutions makes such an assumption untenable. And yet, in the realm of the planning and execution of fiscal programs, our traditions and concepts are geared to the assumption of a static role for fiscal policy.

Developments everywhere have made it apparent that governmental fiscal policy is necessarily a mutable thing which tends to change with new political concepts and ruling groups and with new economic conditions. But at all times in modern society—and this point must be extremely clear—fiscal policy functions within a budgetary context. An eminent Swedish economist, in referring to governmental attempts at a solution of the financial problems, recently declared:

> The shortcomings of the new fiscal policy as it has been tested out in various countries during the last depression are, to a considerable extent, to be explained by the fact that this policy was frustrated as a result of being pressed upon a budgetary system which had been built on principles contradictory to this self-same policy. It is, therefore, just at present an important problem of economic engineering to construct a new scheme of legal and institutional regulations for the fiscal households. . . .[25]

The successful application of a counter-cycle fiscal policy obviously requires careful planning of a coördinated program, and a long-term point of view. It requires, furthermore, a consideration of governmental financial activities at all levels of government, since the important thing is the net result of the

[25] Gunnar Myrdal, "Fiscal Policy in the Business Cycle," *American Economic Review*, vol. 29 (March, 1939, Supplement), p. 186. Reprinted with permission of the *Review*.

impact of the public economy on the private economy. But all these elements were lacking in the recent fiscal program. The budget system was geared to a year-to-year financing of regular, recurring federal services. The budgetary techniques employed were incapable of successfully planning a long-term unified program of deficit financing. There was no single governmental agency, with adequate facilities, to coördinate the whole recovery program and to supply the necessary information. At the same time that the Budget Bureau was busy examining the individual items of expenditure along traditional lines of economy, the President was allocating huge sums entirely outside the budget system. In addition, independent agencies, with powers of obtaining funds and spending, were multiplying at a rapid pace. Although this may have been necessary in view of the need for speed and flexibility, it certainly helped to prevent the development and execution of a unified program.

The question as to whether or not the administration could have been more successful in executing a policy of deficit financing if it had possessed better tools of planning and coördination is not, for us, the major issue. We are concerned, rather, with the implications of our recent fiscal and budgetary experience for public policy in general.

THE PLACE OF THE BUDGET IN THE SOCIAL STRUCTURE

We can proceed on the assumption that economic stabilization has become the direct responsibility of the government as the ultimate guardian of the public welfare. Governments today rise and fall largely on their ability (or luck) to satisfy the more important social needs, and this, under existing conditions, means to prevent the ravages of depression. As the problems of stability and security become increasingly crucial issues of political import, it can be expected that governments will be more and more concerned with the successful planning and carrying out of fiscal policies aimed at their solution. The problem of our democracy has become one of retaining popular control over a government which is asked actively to promote economic stability and social security.

In a democracy the chief concern must be, naturally, with the formulation of social objectives and the translation into action of such objectives through democratic means. If the

democratic process has meaning and vitality, then popular control must be most effective at the level of policy formulation and in the selection of policy executors. But, at the same time, the agents of the people must be effectively equipped if the social objectives are to be achieved. Essential to the translation of policy into action is a flexible and efficient machinery for the planning and carrying out of fiscal programs. The budget is clearly the instrument most suited to such a task. But there is a serious need for a careful study of possible improvements in the budget process and in budgetary techniques if the successful planning and execution of financial programs are to be assured.

The prevalent ideology which conceives of public budgeting in terms chiefly of control and economy, under the aegis of traditional principles, casts a mist of unreality over the major issues. These are obviously in the realm of social objectives and fiscal policy. Any view of public policy can be reduced to a combination of group interests which, after being identified with the public interest, are offered as the basis for governmental action. Our political debates arise over differences about which parts of the social whole are to be identified with the common welfare. Our democracy is predicated upon the belief that from the clash of diverse objectives and pressures a line of public policy will be established that will advance the interests of a very great proportion of the population.[26]

At the level of fiscal policy, and in addition to the questions of diverse group interests, arise the controversial issues concerning the course which might best meet the social needs. Is a solution of the problems of instability and unemployment to come from within the private economy, left free to solve its own problems? Those who hold to this view insist that although the business cycle is inherent in the capitalistic system, the severity and length of the depression period can be minimized if a *natural* recovery is permitted. The state must "tighten its belt" and create an atmosphere of confidence so as to encourage the business community to get their affairs in order and then forge ahead. And a balanced budget is considered essential to such confidence.

Or can the government overcome instability by a long-run, counter-cycle policy? Under such a policy the government must

[26] Pendleton Herring, *The Politics of Democracy* (New York, 1940).

adopt a program of deficit spending in depression to be offset by surplus financing during subsequent prosperity. This means that annual budget balancing will have to be abandoned in favor of a rough balance over the period of a complete business cycle.

Or, again, is a program based on a large volume of permanent investment necessary to assure the full employment of the factors of production? Such a policy would mean that instead of balancing the budget annually, or even over the period of the business cycle, a progressive rise in the public debt would be the course relied upon to fill the gap left by inadequate private investment.

The mere summary statement of a few of the alternatives of fiscal policy, actual and theoretical, makes it clear that the traditional concepts of government budgeting are predicated on a definite preconception of the type of fiscal policy deemed desirable. A balance between current revenue and all expenditures within the fiscal year is only one of the many possible courses which may be followed. It is of course possible that those who have the mandate of the people may interpret social welfare as best served by such a policy. But, on the other hand, it is just as likely that an alternative policy may be decided upon. Certainly the question of fiscal policy to be pursued cannot logically be decided on the basis of budgetary traditions. Such phrases as "balanced budgets" and "extraordinary budgets" are, under existing conditions, more useful for exhortation than for analysis. Emphasis should be shifted, as Herring suggests, "from the vindication of abstractions to the study of concrete data and to the discovery of administrative devices that will get the job done."[27]

The problem of government budgeting has become one mainly of skill in adjustment. The criterion for judging budgetary techniques and procedures must be the degree to which they aid in successfully planning and carrying out governmental fiscal programs, and not the extent to which there is strict adherence to a preconceived set of principles.

WHAT IS "SOUNDNESS"?

The question which immediately arises is, does not such a conception of governmental budgeting carry with it implica-

[27] *Ibid.*, p. 414.

tions of constantly changing budgetary policies and techniques, and will not such a phenomenon have serious repercussions on the fiscal soundness of the government? Such a question derives directly from recent financial experience, which has been marked by continually changing governmental fiscal policies, attended by popular fears of the implications for soundness. We are, undoubtedly, passing through a transitional stage in our development. The relation of the state to the private economy had not yet been defined. The proper role for fiscal policy in the promotion of stability and security is still an extremely moot point. Under such conditions, the soundness of the fiscal system has particular significance, but, at the same time, soundness becomes a goal whose achievement is extremely difficult.

Two important questions arise in this connection: What is fiscal soundness? And how is the desired degree of such soundness to be achieved? Financial developments throughout the world have made it clear that there is nothing in fiscal reality corresponding to a conception of absolute financial soundness with the implication that one fiscal system is "sound" and another "unsound." This notion can only be defined in relation to a particular fiscal household, and even then merely in a relative sense. The soundness of a fiscal system can be judged, then, only on the basis of the criterion established within the fiscal household. Such a decision becomes a matter of primary importance.

> The degree of soundness to be kept up in a system of public finances being the basic principle of fiscal policy, it must be established by a political decision. . . .
>
> It befits an enlightened democracy not only to make this fundamental decision and to stick to it, but to base it not upon abstract stereotypes of definitions and the meaning of the terms, but upon an economic analysis in rational terms of the effects of a choice of one or another degree of soundness: effects on the trend of total capital formation, on income distribution, on the development during future periods of the tension between necessary taxation on the one hand, and, last but not least, the effects on public confidence.[28]

Once it is clear that fiscal soundness cannot be an absolute concept, but must depend upon individual political decisions,

[28] Myrdal, *op. cit.*, pp. 186–187.

it becomes equally clear that budgetary policy cannot logically be based on a preconceived set of absolute principles, but must be geared to the financial programs adopted in the fulfillment of the basic political decision. The budget, then, can serve financial soundness best by aiding the successful planning and execution of fiscal policy, and by introducing regularity and system into government finance. The important problem is one of getting things done. Under present conditions, frustration is a more serious threat to democracy than any willful act of officeholders.

Certainly, that nation is not "sound" which adheres religiously to strict rules of budgeting, but lets its land lie waste and its machines idle. Nor does that country assure the democratic way of life if it imposes a thorough system of budgetary controls, but permits its farmers to be forced off their land and its city workers to wait vainly for factories to open. The problems of soundness and control go right to the heart of the democratic process and of the capitalistic system. Principles of public budgeting cannot be treated in a fiscal vacuum, but must be looked at in the context of social needs, political aspirations, and economic conditions. The principles of democratic budgeting must be the principles of a nation seeking to solve certain of its problems through collective action, and using the budget machine as a springboard for such action.

THE INVESTMENT BUDGET*

Spencer Thompson

SUMMARY

THE *expansion of the federal government into fields formerly serviced by private enterprise has given rise to new budgetary problems. Because many of these new expenditures are capital investments, the investment budget has been developed. It is only a statement of the capital outlays and the source of funds to be used. Capital outlay statements are compiled from the more fundamental annexed budgets. An annexed budget is a planned expenditure program for an agency. Their principal feature, not contained in the regular budget, is a charge for depreciation which is necessary to a clear picture of current cost of operation.*

In Denmark and Sweden specific proposals for the investment budget were prepared by government appointed committees of prominent businessmen and scholars, and the reports of these committees were given wide circulation in order to acquaint the public with the principles of budgeting for capital outlays. The subsequent success of the investment budgets in Denmark and Sweden can be attributed largely to the soundness of the committees' proposals and the integrity with which the capital accounts have been maintained in practice.

Professor A. H. Hansen summarizes the steps which the United States has taken toward a capital outlay budget in his forthcoming book

*This article on the investment budget is the result of a study which was started at the Harvard Graduate School of Public Administration in the fall of 1938. The study was directed by Professors C. J. Friedrich, A. H. Hansen, M. B. Lambie, and Dr. E. P. Herring. Robert H. Rawson and W. Spencer Thompson, Fellows in the Graduate School, were associated in the study. Through the coöperation of D. W. Bell, former Acting Director of the Bureau of the Budget, W. A. Jump, Budget officer of the Department of Agriculture, and Major F. A. Silcox, former Chief of the United States Forest Service, arrangements were made for this research to include a case study of the United States Forest Service. In May 1939 the initial results of the study were discussed at Harvard with a group of interested public officials. No definite agreement was reached concerning the application of the general principles of the investment budget to a possible budget for the Forest Service.

Later in the summer of 1939, Major Silcox asked David Cushman Coyle to draft an investment budget program for the Forest Service. At that time Mr. Thompson made the findings of the Graduate School study available to him. The result was a memorandum which resolved most of the perplexing problems to the satisfaction of Major Silcox and Mr. Thompson. To the sorrow of his many friends and associates, Major Silcox died suddenly in the fall of 1939, with the result that Mr. Coyle's memorandum was not published. However, the section on the budget for the Forest Service in the following article is from this memorandum.

on fiscal policy and concludes that the time is now ripe for an exhaustive study to be made of the subject. If a comprehensive survey is undertaken it might best be made by a small non-partisan committee of prominent citizens appointed by the President and provided with an adequate research staff. The ultimate success or failure of an investment budget in this country will depend upon the acceptance of the basic principles by both political parties and the maintenance of the depreciation and capital accounts in accordance with accepted accounting methods.

The study of the Forest Service is presented as a concrete example of how the investment budget might work. This service is therefore treated as if it were a subsidiary enterprise all the stock of which is owned by the Treasury.

The book value of this stock is equal to the assets of the Service which consist of three classes.

Land now owned is placed at a nominal book value of $1.00 per acre. Newly purchased land is added at its cost price.

Forest is listed at current estimated capital value, whether mature or young. The yearly increase in appraised value is considered as income: the portion not sold is added to assets, or "ploughed in." Actual appraisals will be at long intervals, and used to correct the yearly estimates.

Improvements are charged with interest and depreciation, the current book value being listed as an asset.

In recommending a program for future years, the same methods of bookkeeping are used for estimating investment and service charges.

THE EDITORS

THE expansion of the activities of the federal government into fields formerly serviced by private enterprise has given rise to the consideration of the revision of the budget statements of the federal government to reflect capital outlays. Loans to business men and farmers, the construction of Boulder Dam and TVA, the purchase of the Panama Railroad, and the operation of a merchant fleet are government investments which closely resemble the capital outlays of private enterprise. Capital expenditures are of a different character than the older ones for the Army and Navy, war pensions, federal courts, and regulatory agencies, and they have helped to swell the federal expenditures from 2 per cent of the national income in 1913 to 15 per cent of the national income in 1938.[1]

The United States is in a small measure experiencing what has developed much further in Europe. England, France, and

[1] From unpublished data made available by Dr. E. C. Munzer.

Sweden have seen the proportion of government expenditures to national income expand from 13 per cent, 12 per cent, and 10 per cent respectively in 1913 to 30 per cent, 40 per cent, and 25 per cent in 1938.[2]

Because a large part of the recent increase in government expenditures has been for capital investments—state forests, government railroads, hydro-electric projects—several countries have developed what is called the investment budget.

THE INVESTMENT BUDGET DEFINED

The investment budget is a financial statement of the government's expenditures for capital improvements—whether the improvements are for new capital developments or for the modernization and improvement of older capital developments which have depreciated. The establishment of the investment budget involves the division of the regular budget into two parts: current expenses and capital outlays. The statement of expenditures for capital outlays is called the investment budget and the statement of expenditures for current expenses becomes the regular budget.

The investment budget itself is only a statement of the capital outlays and the source of the funds to be used, i.e., borrowing, depreciation, reserves, or special taxes such as estate or gasoline taxes. The capital outlay statements are compiled from the more fundamental annexed budgets which are the heart of the investment budget system. An annexed budget is a planned expenditure program for an agency, such as the R.F.C., which is charged with the administration of large capital outlays. An agency of this kind is treated as though it were a corporation owned by a single stockholder—the government.

The agency would be required to maintain accounts similar to a private corporation so that appropriate balance sheet and profit and loss statements could be made. The account would report as income all fees and fines collected, the regular appropriation of Congress to the agency for operating expenses, capital gains, and any other miscellaneous income such as gifts or special taxes. The appropriation of Congress would be in the nature of a public subsidy to this particular activity. As expenses, the accounts would report expenditures for operation,

[2] *Ibid.*

maintenance, and depreciation (including capital losses). The accounts would also make available a current statement of the value of capital investments under the jurisdiction of the agency. Only the net profit or loss (including capital gains or losses) of the agency for the year just concluded would be charged to the regular budget as income or expenditure and the supporting profit and loss statement would be annexed to the regular budget—hence the name, annexed budget.

ANNEXED BUDGETS

The principal feature of an annexed budget which is not contained in the regular budget is the charge for depreciation. David Cushman Coyle has given the following clear definition of depreciation:

> When public money is expended for any property that will last beyond the end of the fiscal year, the remaining value still left at the end of the year is an asset.
>
> Depreciation is the loss of value of an asset that wears out or becomes obsolete over a period of years, until the asset value recorded at the end of the first year has been completely wiped away. Depreciation is an operating expense; the corresponding funds are charged to operation, and transferred to capital account to be used for amortizing the capital value of the depreciating asset, or for replacing it with a new one.[3]

The charge for depreciation is necessary for a realistic presentation of current costs of operation. For example, the oldest federal "business enterprise", the Post Office, shows a book profit, but no one has a definite estimate of what the profit or loss might be if the Post Office accounts carried an adequate depreciation charge for the space occupied in federal buildings.

In his message transmitting the budget for the fiscal year 1940, issued on January 3, 1939, President Roosevelt presented a clear case for the use of annexed budgets as follows:

> The public has been showing an increased interest in the adoption by the Government of a form of budget which would conform more nearly to the practice followed in commercial business. There has been some criticism of the Government's practice of including in its budgetary expenditures amounts disbursed for loans, or for self-

[3] From an unpublished memorandum prepared by D. C. Coyle for the U.S. Forest Service.

liquidating projects, or for other extraordinary capital outlays which increase the wealth of the nation.

I recognized the merit of constructive suggestions of this nature by recommending in my last Budget Message a change in the method of financing the requirements of the Commodity Credit Corporation. This recommendation provided for an annual appraisal of the assets and liabilities of the Corporation, and contemplated that any surplus from operations or any impairment of capital resulting from losses be reflected as receipts or expenditures in the annual Budget. Under this method the Budget would be affected, not when the investment or loan is made, but in the fiscal year when the surplus or loss occurs.

Congress approved this recommendation in the Act of March 8, 1938, and it might well give consideration to an extension of this principle to other governmental corporations and credit agencies such as:

Agencies under the Farm Credit Administration
Electric Home and Farm Authority
Export-Import Bank of Washington
Farm Security Administration
Federal Crop Insurance Corporation
Federal Savings & Loan Insurance Corporation
Home Owner's Loan Corporation
Inland Waterways Corporation
Panama Railroad
Reconstruction Finance Corporation
Rural Electrification Administration
U. S. Maritime Commission.

* * * * *

While I do not advocate that the Government capitalize all of its expenditures for physical improvements, it seems to me that such portions of the cost of public projects as are clearly self-liquidating should occupy a separate category in budgetary reporting. Our financial statements, of course, should clearly reflect, in appropriate classifications, the amount of Government outlays for physical improvements that are not self-liquidating in character. We must take into account the necessity for making such of these and other changes as will permit the presentation to the Congress and to the public of more accurate and intelligible statements of the financial operations of the Government.

The President's budget message served to bring the subject of revising the budget statements of the federal government

before Congress and the public, but it did not present a definite proposal for the investment budget. The problems of setting up proper accounts for depreciation, capital gains and losses, and interest were not solved nor was the question of the proper relations between a current budget, annexed budgets, and an investment budget answered. The study conducted at the Graduate School of Public Administration, using the President's message as a starting point, investigated the investment budget systems of Denmark and Sweden and made a case study of the U. S. Forest Service. The results of this study, as it has been modified by criticisms of Dr. Gunnar Myrdal and the officials of the Forest Service and the additional work of David Cushman Coyle, are presented in the following sections.

THE INVESTMENT BUDGET OF DENMARK[4]

In 1927 Denmark inaugurated an investment budget system which offers a logically consistent example of government accounting in the form of two separate but interrelated statements, (1) the current or operating budget, and (2) the investment budget.[5] Every capital outlay is entered on the investment budget. No distinction is made between self-liquidating assets, and non-income-yielding assets such as schools and public buildings. Durability, not revenue-producing, is the criterion applied to outlays reported in the investment budget. Capital investments are financed by borrowing, by depreciation allowances, and from inheritance taxes.

All investments are expected to earn an income adequate to cover not only expenses of operation, but also 5 per cent interest, and depreciation or amortization charges. Investments earning no income directly look to the regular budget for income to cover these charges. Denmark has annexed budgets for all agencies administering government investments and has even set up a corporation of Public Buildings which collects rent from all agencies using these buildings. Thus each branch of the government (e.g. a state hospital or school) must include in its expenditure estimate, not merely the usual operating expenses, but also an amount sufficient to cover interest and

[4] The substance of the description of the investment budget of Denmark is also contained in the forthcoming book on Fiscal Policy by Alvin H. Hansen, a faculty collaborator on The Graduate School study.

[5] Brenley, Thomas, *Monetary Policy and Crisis* (London, 1936), pp. 125–9.

depreciation. These expense items entered in the regular budget are defrayed from general tax revenues. Thus the current budget carries the interest and depreciation charges originating in the capital budget of a non-self-liquidating public investment project.

With adequate provision for depreciation and amortization the investments of the government should always, barring drastic changes in the price level, have a current value at least equal to the outstanding public debt; and, insofar as the capital outlays have been financed by inheritance taxes, there should be a surplus of assets over the debt obligations. The Danish public accounting procedure is fully developed to include all government properties, and it is possible to present annually a statement of national debt and the net value of national assets. If the ordinary budget shows a balance in any one year, such balance would show up as a net addition to the net assets in the state aggregate asset account; a deficit in the ordinary budget would reduce the net assets. The Danish budget thus illustrates a fully developed capital accounting procedure applied not only to the government's income-yielding assets but also to public investments which are non-productive of monetary income.

THE SWEDISH BUDGET

The investment budget system of Sweden was patterned after the Danish system but differs from it in two important respects: (1) no interest is charged against the investments, and (2) no investments are entered in the investment budget unless they are self-liquidating. Durable investments not yielding an income from fees and other service charges are treated as current operating expenses.

While no interest is charged against the book value of the investment in Sweden, the government agency administering the investment is expected to earn a normal profit of approximately 4 per cent on the outlay. If for any reason the activity does not earn the expected profit, the government either increases the charges for the service rendered or the book value of the investment is depreciated until 4 per cent is realized. A book depreciation is called a windfall loss and the amount of the depreciation is charged to the regular budget as an expense to be met from taxation.

In recent years Sweden has broadened its definition of a self-liquidating investment to include an income-yielding investment which must be subsidized by regular appropriations from the current budget. An example of this activity is a low-cost housing project in which the tenants pay part of the cost of operating, maintenance and depreciation charges, and the government contributes the balance, including enough to show a 4 per cent return on the invested capital. By this broader use of the concept of self-liquidating activities Sweden has capitalized virtually all capital outlays, approaching the Danish practice.

The difference between Denmark and Sweden in the matter of handling interest is essentially one of definition. The normal profit expected of an investment in Sweden is but another name for the interest charge of Denmark. What may be a more satisfactory method of treating this question of interest is presented in the following case study of the United States Forest Service.

A CASE STUDY OF THE UNITED STATES FOREST SERVICE[6]

Conservation is often called an investment because of the fact that the future wealth of the country will be larger with conservation than without it. For example, Mr. C. S. Martin of the Western Pine Association, in recommending a public expenditure for controlling white pine blister rust, said: "It seems to me that if an expenditure of approximately 10 or 12 million dollars will save an industry producing $15,000,000 annually, it is a good investment."

This statement is not exaggerated, for there can be no question that the expenditure would be well justified.

In an accounting sense, however, it is clear that the expenditure of 12 million dollars would not add any new pine trees or increase the present ability of the industry to pay taxes. It would merely prevent a loss and preserve the present value of the industry. Expenditure for the general defense of property is a proper charge on the taxpayers, but it produces no new assets, and cannot therefore be placed on the books as an addition to capital.

On the other hand, it remains true that a part of the expenditures of the Forest Service result in additions to the assets of the

[6] This part of the article is essentially in the same form as it was presented in Mr. Coyle's memorandum for the Forest Service.

Service itself. As a separate agent of the nation, the Service is more than maintaining its property; it is increasing its assets and is therefore making investments.

Public assets belong to two main classes, first those which produce a money income, and second those which are held for public use but produce no money income.

In the first class are federal interest-bearing loans to municipalities and private borrowers, their asset value being measured by the extent to which they will actually be repaid.

In the second class is all property that represents an actual capital value to the government, but does not draw a net income directly from the public.

The Forest Service assets, as a whole, cannot pay a net income to the Treasury, because so large a part of the duty of the organization is made up of conservation and public services which are supported by general taxation.

The Forest Service assets are of three kinds: land, stumpage, and improvements.

Land

Land now held by the Forest Service is listed at a nominal value of $1.00 an acre, to indicate that it has a value, although there is no practical utility in attempting an exact appraisal, as the land is not for sale.

Newly purchased land is to be added to assets at cost, on the necessary assumption that the average purchase price is practically the market value.

The relation of this asset to the general public debt should be made clear. Some land may be bought in a year when the Treasury has a general deficit, other land may be bought in a year of surplus. It might seem that land purchased from surplus funds had a different status, although the money might have been used instead for retiring federal bonds. In practice, it is usually more economical to buy land in time of depression, when there are no surplus funds; in consequence, it would be unrealistic to show on the books any apparent disadvantage upon land acquired at such times.

Stumpage

Stumpage, or growing trees, on cut-over lands such as the majority of the national forests, should be regarded as fixed capital in process of accumulation. The typical tract now con-

tains far less timber than will be required in a permanent sustained yield forest. This fact has to be recognized in accounting for the growth on such lands.

In a mature forest under sustained yield management, the sales may be equal to the growth each year, and the accounting process then is clear. Operating costs are regarded as yielding a product for sale, the proceeds being credited as operating income. For a limited number of years, the timber may be held off the market and will accumulate with little or no loss through overmaturity. In that case, the unsold product can be said to be added to inventory. It is a temporary investment, intended to be liquidated before the trees begin to lose value.

In a newly planted or immature forest, however, the yearly growth is not expected to be cut. This annual increment is, to be sure, a production of value, and therefore should be credited as an income, helping to offset operating expenditures. But the additional volume of growing wood is left standing, until the forest becomes mature. Thereafter, the producing forest is to be kept permanently at a volume that will yield the best annual production. Thus the product of the years before maturity is never liquidated but remains permanently embodied in the forest, though it will be transferred from tree to tree or from acre to acre as the forest is harvested. This preliminary production, in other words, is laid down as fixed capital.

In order to show a correct picture of this process year by year, the annual net increase in capital value, allowing for growth, changes in markets, and losses by fire or disease, must be accounted as current income. Otherwise the books would show a false deficit during the years of growth and a false profit when the mature forest suddenly appears in the role of a producing unit.

A correct accounting would be obtained by transferring each year the increment of value to the capital account, and paying over a corresponding sum of money, counted as investment from capital to operating account. That is, the capital account buys the annual product and lays it down as fixed capital. Since it is not practicable to make an accurate yearly appraisal, it is proposed to transfer a conservative sum each year, correcting the total at ten-year intervals or whenever more accurate appraisals are made.

Whether the appraisals cover mature or immature forests,

the results may be treated together. Net change in appraised value combines all factors, giving a figure which is then treated as income ploughed into capital assets.

The adoption of an accounting system covering steady increase of growing stock is essential because of the fact that for the next fifty or a hundred years the Forest Service will be chiefly occupied in accumulating new stumpage as an offset to the depletion of favorably located private forests.

Improvements

The third type of assets is made up of buildings and other operating equipment, used either for the production of marketable products or for the public services of the bureau. These improvements, when made, become capital assets, subject to depreciation. The annual loss of value is covered by transferring a corresponding sum of money from the operating account to the capital account for the reduction, or amortization, of capital liabilities.

In accounting for all capital assets, the Forest Service is regarded as the direct "owner", subject to a liability to its sole stockholder, the Treasury, equal to the total assets. Of the money appropriated and paid by the Treasury to the Forest Service, it is assumed that a sum equal to the net increase in assets has been invested by the Treasury. The Treasury then holds, in its own asset account, an obligation of the Forest Service equivalent to 100 per cent stock ownership.

The purpose of interest in private industry is to persuade the investor to risk his capital. Although on the average he may lose, on the other hand he may be fortunate, and the interest rate allows for the risk. The government is not moved by the same considerations. It is obliged by the duty of a sovereign nation to conserve and increase its resources, regardless of whether its citizens will pay the bill through the purchase of products or through taxes. Moreover, its forest operations are not planned for the purpose of being fortunate at the expense of other forest owners, but rather the contrary. It does not hope to have even the average rate of profit, but to take the less profitable lands and make them productive. Interest is therefore meaningless in the decision of public policy on long-term operations such as forests.

Land purchased by the government is likely to be held for a hundred or a thousand years. Its value will depend on changes in national life which have no connection with interest rates. The book value of the land cannot be accumulated by compounding interest at any rate whatever, over a period in which private capital values are scaled down again and again. As has often been remarked, if Queen Isabella, instead of financing the discovery of America, had invested $3,000 at 6 per cent compound interest, her investment would now have a book value of about 400,000 billion dollars, or several hundred times as much as the two continents are worth. The conclusion is not that the discovery of America was financially unsound, but merely that interest will not accumulate over a long period.

The forest, if it is operated for a sustained yield, is expected to be as permanent an asset as the land. Though each tree grows and is cut, the forest continues undiminished. When a forest is started from the bare land, its value is gradually built up to the point where it can be placed in production. This added value is permanent capital, not a temporary inventory to be liquidated.

Because of the long period of time involved, interest at going rates cannot be paid by forests except in specially favorable circumstances. For the nation as a whole, the national forests have to be treated as permanent assets without obligation to pay interest. If the Indians had believed in compound interest, there would have been no forests here when the white men arrived. Even though the Indians could not use the timber, they would have had to cut it down to avoid bankruptcy.

Land and forest trees are therefore listed as assets bearing no interest, since their period of use is so long that the common meaning of interest rates does not apply to them.

Improvements, consisting of buildings, roads, and other equipment, are considered as having a limited life, and therefore, resemble more closely the capital plant of a private industry. In order to recognize this resemblance, the improvements are charged on the books with interest at the average rate for government borrowing. This is the method of accounting used in Denmark, where public buildings are treated as business enterprises, the government being both tenant and owner.

The distinction between land and forest on one hand, and

equipment on the other, is marked by this distinction as to interest. The government has a duty to increase the total amount of forest resources, regardless of profit to itself. But its duty in regard to buildings and other facilities is to make them as economical as possible, for the purpose in view. Forests are, to a sovereign nation, an end in themselves, buildings are only an instrument. Buildings, therefore, should be treated so as to be comparable with similar capital structures used in industry. The bookkeeping should show, wherever privately owned facilities might be used, the relative cost to the government of owning its own plant rather than renting from private owners.

In the accounts of the Treasury, it is assumed, the three types of assets held by the Forest Service would not appear as separate items. Instead, a single item representing stock in the Forest Service would appear as an asset, in the non-income-producing class, since all income earned by the Service will be used for partial coverage of its general expense.

TENTATIVE DRAFT OF BUDGET FORM
All National Forest Activities, 1938

I. Operating Budget			
A. Receipts			
1. Cash from public			
(a) Sales of timber	2.8		
(b) Fees and miscellaneous	1.9		
		4.7	
2. Payments for capital accretions			
(a) Timber added to capital	12.8		
(b) Timber traded for land	.5		
		13.3	
3. Appropriations			
(a) Operating expense	20.2		
(b) Interest on federal debt	8.6		
		28.8	
			46.8

B. Expenditures			
1. Operation			
(a) Administration	14.6		
(b) Maintenance, fire, insects, etc.	10.4		
(c) Research	1.2		
(d) Tax-equivalent	1.1		
(e) Depreciation, to capital account	10.9		
		38.2	
2. Interest on improvements, to Treasury		8.6	
			46.8

II. Capital Budget Statement			
A. Receipts			
1. Cash from public			
(a) Sales of land		0	
2. Payments from Service account			
(a) Depreciation		10.9	
3. Appropriation for investment		49.7	
4. Donations of land and timber		0	
			60.6
B. Disbursements			
1. To public and employees			
(a) Purchase of land	2.1		
(b) Purchase of stumpage	.9		
(c) Improvements, gross	44.3		
		47.3	
2. To Service account			
(a) For timber added to capital	12.8		
(b) For timber to trade for land	.5		
3. Donations			
(a) Land			
(b) Timber		13.3	
			60.6
Total new investment			
Income and transfers			10.9
Net investment by U. S. Treasury—Appropriation			49.7

III. Assets and Liabilities

	1937	*Minus*	*Plus*	*Net change*	*1938*
Fixed Capital					
A. Land alone	87.7				
Sales		0			
Purchases			2.1		
Trade for timber			.5		
Net addition				2.6	
Total					90.4

Inventory

B. Stumpage	?				
Sales		2.8			
Traded for land		.5			
Increase in value, gross			16.1 ?		
Purchase			.9		
Net addition to value				13.7	
Total					?

Equipment

C. Improvements	286.1				
Depreciation		10.9			
New construction			44.3		
Net addition				33.4	
Total depreciated value:					319.5
Total addition—appropriation for investment				49.7	

IV. Account with Treasury:

Credit:		
I A 3. Appropriation for service	28.8	
II A 3. " " investment	49.7	
Gross total	78.5	
Debit:		
I B 6. Interest to Treasury	8.6	
Net cash from Treasury	69.9	
Allocations:		
Operating Account, appropriation	28.8	
Less interest	8.6	
Net cash		20.2
Investment Account, appropriation		49.7
Total		69.9

N.B. The question marks indicate that the present accounts of the Forest Service do not estimate the stumpage value of United States forests.

THE FORMULATION OF THE FEDERAL BUDGET*

Robert H. Rawson

SUMMARY

WITH *the passage of the Budget and Accounting Act of 1921 the "executive" budget displaced the "legislative" budget. The President's review and revision of departmental expenditure requests is facilitated by the Bureau of the Budget under a Director responsible to the President alone.*

The paper deals with the work of the Estimates Division of the Bureau of the Budget. This work consists in reviewing the requests for funds made each year by the departments and agencies of the federal government. The appropriation acts, which dictate the form of the annual estimates, are complicated by a mass of detailed legislation. Congress is thus able to exercise specific control. There is no consistency in the manner in which Congress uses the voting of small, ear-marked funds to control expenditure. Possible remedies lie in an improved executive control.

The expenditure classification used in presenting the budget estimates is out of date. It is used chiefly in supporting the departmental requests. The new Fiscal Division of the Bureau of the Budget should develop a system which will show the organization units spending money, the functions carried on, the extent to which expenditure is devoted to current and other outlays, the objects of expenditure, and the funds from which the money is taken.

The justifications written by the departments and agencies to support their expenditure requests have often failed to present the essential information in brief, coherent fashion. This has thrown most of the burden of determining the necessity for the expenditure on the hearings held by the Estimates Division of the Budget Bureau. Not enough attention has been directed toward developing objective criteria for judging expenditure requests. The recent reorganization of the Budget Bureau and the increased appropriations may correct these shortcomings, particularly through field investigations. The departments should not be permitted to appeal over the head of the Budget Bureau to the President for a restoration of reductions in budget requests.

Statistics show that the Budget Bureau has consistently cut the department requests and has thus exercised a type of expenditure control.

* The views expressed by the writer throughout this article in no way represent the official views of the Bureau of the Budget, with which the author is connected.

Congress has regularly sustained the Bureau's action. While the departments have not always received all they wanted, they have usually been successful in obtaining more than they had the previous year. Expenditures have, therefore, tended gradually upward.

The biggest problem for expenditure control lies in the deficiency requests for funds. Appropriations of this type are so large that they detract seriously from the significance of the annual budget as an expenditure program.

THE EDITORS

THE FEDERAL BUDGET, as submitted to Congress, is a whole composed of many parts. The administrative process by which those parts are welded into one document reflecting the policy of the President is one of vital importance. For the budget is at once a financial report and a financial plan. Through it the Congress and the people of the United States are informed of the program proposed by the chief executive for the year to come, of the status of the treasury at the half way point of the year in progress and of the results of the financial plan for the last completed fiscal year.[1] The budget translates general policies into specific programs for the ensuing year. In the process policies may be adapted in the light of the facts reported for the last completed year and for the year in progress. The very effort to compress general policies for agriculture, relief, and national defense into one financial plan may also lead to adaptations in one or another of these broad policies. Factors such as debit limits, tax yields, or political expediency may make such compression unavoidable. The process by which the facts of the experience of the recent past and the plans for the immediate future are gathered from the huge sprawling federal government and woven into one pattern is, therefore, of importance to anyone who would understand the nature of the budget document.

This paper will be primarily concerned with the manner in which the United States Bureau of the Budget formulates the federal financial report and financial plan. The policy determining function of the President will not be discussed, although reference will be made to the manner in which the chief executive participates in the essentially administrative process of formulating the budget.

[1] The federal fiscal year runs from July 1 to June 30.

The revenue side of the budget, moreover, although every bit as important as the expenditure side, will not be considered since it is a subject quite distinct from the formulation of spending plans, it involves a different technique, and it is now a function of a separate agency, the Treasury. This paper is concerned only with the questions arising when an attempt is made to consider the expenditure requests of all federal units from the point of view of the government as a whole.

The weighing of the request of any government unit, on its own merits and in relation to those of the requests of all other units, involves elements of both planning and control. On the one hand, all available facts are being used to determine the manner in which the requests individually and taken together, accord with general policies. On the other hand, this review of departmental financial reports and plans permits an appraisal of the manner in which the individual departments followed the lines laid out for them in the budget for the last completed fiscal year. In other words, an opportunity for controlling the execution of financial policy is offered. It is an *ex post facto* control, coming after the expenditure is made, and is not to be considered as a substitute for effective current control of the budget all during the year. But inasmuch as the department officials know that eventually they must account for their stewardship, and that future appropriations may be cut if present appropriations are not adhered to, a form of control is exercised. It was with this in mind that a critic of the British system stated that "in this comparison of items and the resulting selection of those to be reduced or increased is the essence of treasury control over financial policy."[2] This paper will accord due recognition to the control aspects of the formulation of the budget.

Before taking up the review of department requests by the Bureau of the Budget, however, a word should be said with respect to the compiling of the budgets of the various com ponent parts of the federal establishment. The departments and agencies are, of course, far-flung units of government and a large portion of the synthesizing of facts and plans which constitutes the making of a budget is carried on at that level. While the subject cannot be thoroughly explored within the scope of the present article, a few essential points will aid in under-

[2] R. G. Hawtrey, *The Exchequer and the Control of Expenditures* (London: Humphrey Milford, 1921), p. 68.

standing what is to follow. Each major unit of the federal government must, by law, designate an official to act as budget officer. A primary function of this man is to prepare expenditure requests to be submitted to the Bureau of the Budget. Accordingly, he contacts each bureau, division, section, and office of his establishment and asks it to forward to him its expenditure plans. These the budget officer reviews in relation to the policies laid down for his unit by Congress, the President or the department or agency head. Hearings are held at which the bureau and other sub-organization unit heads present the facts, statistics and arguments to bolster their cases. The precise nature of the review will differ, of course, in each department or unit. "The processes by which Federal departments determine their budgetary requirements vary widely, ranging all the way from certain straight-line methods of determination to the most complex of collaborative processes."[3] In many instances, pressure groups are active in urging the adoption of programs on bureau or departmental officials. The budget officer must weigh these requests, whether they originate from pressure groups or the ideas of brilliant research men, submit those involving questions of policy to the secretary or administrator, and finally embody them in a department or agency budget to be forwarded to the Bureau of the Budget.

The action of the Bureau of the Budget on the expenditure requests submitted to it constitutes the theme of this paper. After a brief review of the circumstances under which the present system was adopted and a description of the organization of the Bureau of the Budget, the procedure used in formulating the budget will be presented. The forms used in this process will be analyzed. This, in turn, will involve consideration of the appropriation structure and the expenditure classification. The effectiveness of the budget hearings will be assayed, with the assistance of statistics of estimates and appropriations. Problems of relationship between the President, the Budget Bureau and the departments will be explored. Finally the difficulties for financial planning created by the voting of large sums after the budget has been accepted will be considered.

[3] W. A. Jump, ***Budgetary and Financial Administration in an Operating Department of the Federal Government***, a paper presented at the Conference of the Governmental Research Association, Princeton, New Jersey, September 8, 1939.

THE ADOPTION OF THE EXECUTIVE BUDGET

For many years the federal government had a "legislative" as contrasted with an "executive" budget. This meant that the Congress formulated the budget. The President undertook no review of the departmental proposals for expenditure. The Secretary of the Treasury gathered the estimates together and forwarded them to the Congress but he took no action on them. The estimates came to an overworked legislature without any previous review or coördination.[4] This situation may be attributed to the desire of the Congress to maintain control of the purse strings and it continued until 1921. For many years prior to that date there had been a gradual accumulation of sentiment in favor of an executive budget. Perhaps the foremost overt demonstration of this sentiment was the appointment, by President Taft, of a Commission on Economy and Efficiency. This Commission, aided by the services of Dr. F. A. Cleveland, a pioneer in the field, published a report recommending an executive budget.[5] The Congress, however, failed to take action.

The view that although Congress must retain the actual power of the purse, the increasing complexity of government required an expert preview of expenditure demands gained wider currency as the years went by.

> The legislator is busy and his time is scant. Formal 'estimates' presented by the department and bureau chief, revised after hearings and investigation by the budget-making board or officer, and brought together in such form that general oversight and comparison are possible and easy, cannot fail to be of great assistance to the legislature.[6]

This view finally prevailed and in 1921 the Congress passed the Budget and Accounting Act.[7] This legislation instructed the President to submit a budget on the first day of each regular session of Congress which would set forth in summary and in

[4] See W. F. Willoughby, *The National Budget System* (Baltimore: Johns Hopkins Press, 1927) for a criticism of the financial procedure existing before 1921.

[5] *The Need for a National Budget*, a message from the President of the United States transmitting a report of the Commission on Economy and Efficiency (Washington: Government Printing Office, 1912).

[6] C. C. Plehn, *Government Finance in the United States* (Chicago: A. C. McClurg and Co., 1915), p. 98.

[7] 42 Stat. L., 20.

detail the estimates of expenditures necessary in his judgment for the support of the government for the ensuing fiscal year, his estimates of receipts under existing law and under any proposed revenue legislation, the expenditures and receipts for the last completed fiscal year, estimates of expenditures and receipts for the fiscal year in progress, balanced statements of the actual or estimated condition of the Treasury for each of these periods, all essential facts regarding the bonded and other indebtedness of the government, and such other financial statements and data as in his opinion were necessary or desirable in order to make known in all practicable detail the financial condition of the government. The Budget and Accounting Act thus went far towards recognizing the President as the "business manager" of the federal government. His position at the apex of the administrative hierarchy was legally accepted. Congress by no means relinquished the power of the purse in taking this action. The legislature is free to act on the President's budget as it sees fit. Appropriations, moreover, are made direct to the spending units rather than to a central agency for subsequent allotment to those units, as is the case in England. The Act, therefore, introduced a system which is conducive to a business-like handling of federal finances without seriously impinging upon Congressional control.

THE BUREAU OF THE BUDGET

The Budget and Accounting Act also provided the President with a staff agency, the Bureau of the Budget, to aid him in dispatching his responsibilities under the law. In the words of its present Director, the role of the Bureau ". . . is nothing more nor nothing less than to serve as agent of the President in his job of management and to help execute whatever program or policy the Administration may have undertaken." He further stated that "the Bureau of the Budget does not make the policy of the government. The President and the Congress make the policy."[8] The Budget Bureau is headed by a Director aided by an Assistant Director. Both are appointed by the President and ratification by the Senate is not required. This

[8] H. D. Smith, *The Role of the Bureau of the Budget in Federal Administration*, an address given at a joint meeting of the American Political Science Association and the American Society for Public Administration, December 28, 1939.

fact further emphasizes the position of the Bureau as a managerial arm of the chief executive.

The Director of the Bureau is vested by law with the responsibility of building up the rest of the organization. While changes have occurred in the years since 1921, it will be sufficient for present purposes to outline briefly the form which the organizational structure of the Bureau has assumed as a result of the internal reorganization which began in April 1938 and is not yet quite completed. There are five major divisions in the Bureau. The Estimates Division is the largest and carries on the fundamental task of reviewing the expenditure proposals of the departments. It also attempts to exercise current budgetary control by seeing that the departments do not spend more during the year than the amount allowed them by Congress. The Legislative Reference Division coördinates the contacts between the executive and legislative branches of the government. All suggestions for legislation on the part of the departments, as well as all reports on legislative matters made by them at the request of Congressional committees are reviewed by this division. The Estimates Division aids in the task wherever possible. The Administrative Management Division considers problems of organization and procedure referred to it by Congress, the Estimates Division and the departments and agencies. It also conducts research on general governmental organization and procedure and makes recommendations to the President. The Statistical Standards Division will carry on the work of the Central Statistical Board, the functions of which were transferred to the Budget Bureau by Reorganization Plan Number One, in pursuance of the Reorganization Act of 1939. This unit is responsible for the coördination and improvement of the statistical services of the government. The Fiscal Division at present is concerned primarily with the mechanical features of the budget, such as the compilation of tables, the keeping of records, and the problems attending the actual printing of the complicated budget document. The Division is not yet fully manned, however, and in the future its functions will be expanded to include studies of state, local, and foreign government budgets and fiscal policies; analyses of federal budget forms and procedures; studies of expenditure classification and related activities. Finally there is a Service

Section for handling mails and files, accounts and supplies, the stenographic pool, and the messengers.

The unit which is primarily concerned with the review of the departmental estimates, and hence with the formulation of the budget, is the Estimates Division. The authority of the Bureau to "assemble, correlate, revise, reduce or increase the estimates of the several departments or establishments"[9] is assigned, for the most part, to this Division. The remainder of the paper will be devoted to an analysis of the manner in which the responsibility accompanying this authority has been discharged. How effective has the review of departmental expenditure proposals by the Bureau of the Budget been? Has the procedure developed since the passage of the Budget and Accounting Act of 1921 succeeded in providing that expert preview of requests for funds which is the essence of a scientific approach to the problem of financial control in a democracy? To what extent has the Budget Bureau stemmed the tide of expenditure demands rolling in from the departments or channelled it where an absolute curb has not been in line with policy? Has the Bureau been able to unearth the facts permitting clearer decisions on budget policy? Finally, since Congress has retained the authority to increase or reduce the figures arrived at by the Budget Bureau and the President, what are the facts as to the attitude of the legislature toward the financial programs embodied in the budgets?

THE MECHANICS OF BUDGET FORMULATION

One of the basic problems is that of the accuracy of the estimates submitted to the Congress by the President. This, in turn, depends on the ability of the Budget Bureau to test the accuracy of the estimates submitted by the spending agencies. "Speaking generally, it may be said that inaccurate estimates imply looseness of control, and, while introducing disorder into the public finances, they tend to extravagant administration."[10] Accuracy will depend, in large part, on the procedures established, and the instructions issued, by the budget formulating agency. In analyzing the work of the federal Bureau of the Budget, therefore, it is essential to establish a measure of fa-

[9] Budget and Accounting Act, Sec. 207.
[10] A. J. V. Durell, *The Principles and Practice of the System of Control Over Parliamentary Grants* (Portsmouth: Gieves Publishing Co., 1917), p. 283.

miliarity with the mechanical features of the estimates process. "Budget procedure is admitted by all critics to be an indispensable element of control."[11] The time and space required to outline the manner in which the estimates proceed from the departments to and through the Budget Bureau may, consequently, be considered well spent. The foundation will then be laid for a more critical examination of certain important phases of the process.

The initial step in the formulation of the budget is taken by the Director of the Bureau who, in June or July of each year, issues a circular calling for the submission of estimates of appropriation for the fiscal year subsequent to that beginning on July first of that year.[12] The Budget and Accounting Act requires that the estimates be transmitted to the Budget Bureau on or before September fifteenth.[13] The only exceptions are made in the case of Congress and the Supreme Court. Their estimates have to be in by October fifteenth and they are included in the budget in the same amount as submitted.[14] This is a concession to the American theory of separated powers. It was felt that control over appropriations would break down that independence which should exist between the Executive, Legislature, and Judiciary. Should any department, establishment, or agency fail to furnish an estimate by September fifteenth, the President is free to have it prepared as he sees fit. And in any case, the President has the authority to determine the form, manner, and detail of the estimates.[15]

The principal forms which have been prescribed under this authority are three in number. There is the estimate proper, the schedule of obligations, and the justifications for the estimate.[16] These three components of a complete estimate may be likened to the head, body, and legs of a human being. The head, or estimate proper, is presented in the language of the appropriation act of the preceding fiscal year. When a change is to be made in this language the omissions are enclosed in brackets

[11] A. G. Buehler, "The Methods of Controlling Government Expenditures," *Bulletin of the National Tax Association*, vol. XX (November, 1934), p. 36.

[12] The call for the estimates for 1941 was embodied in Budget Bureau Circular No. 350, issued July 1, 1939.

[13] Sec. 215.

[14] Sec. 201 (a).

[15] Sec. 216.

[16] The estimate proper is typed on Standard Form No. 3 and the schedule of obligations on Standard Form No. 3a. The justifications form is not standardized and will be described below.

and the substitute or additional phraseology and amounts are placed in a special column to the right. The proposed changes are thus thrown into bold relief. No explanations are included at this point. The total amount requested and the general purposes for which it is to be expended are clearly set forth. This is the part which is to be enacted into law. It is evident, therefore, why it is compared with the human head.

The schedule of obligations, or "green sheet" as it is professionally termed because of its distinctive color, lends itself to analogy with the human body because it provides the details which give form and substance to the estimate. These obligations are listed primarily by the objects for which the expenditures are to be made. Three columns are provided which are designed to include an estimate for the fiscal year to come, a figure for the year in progress which is part estimate and part reality, and an actual figure for the expenditures of the last completed fiscal year. The objects of expenditure are presented according to a classification established by the General Accounting Office.[17] The objects, such as Personal Services and Supplies and Materials, are grouped under the character headings Current Expense, Fixed Charges, Acquisition of Property, Payment of Debt, and Capital Outlays for Rights and Obligations. The main objects of expenditure are identified by two figure symbol numbers, such as 01 Personal Services, 02 Supplies and Materials, and so on down to 53 Refunds, Awards, and Indemnities. Each of these is further broken down and the subdivisions are characterized by four figure symbol numbers, such as 0200 Stationery and Office Supplies, not Specified. In a few instances a further refinement is indicated by five figure symbols, such as 02011 Printed Forms and Letterheads.

Personal Services now constitute the largest single object of expenditure. In 1939 over 20 per cent of the total general expenditures went to those receiving salaries from the government. None of the objects listed under fixed charges, property acquisition and so on reached this figure. The second ranking object of current expenditure, as distinguished from the categories just mentioned, was only 3 per cent of the total.[18] Be-

[17] *Bulletin No. 1*, May 11, 1922 as revised August 26, 1927 (Washington: Government Printing Office, 1927).

[18] *1941 Budget* (Washington: Government Printing Office, 1940), Informational Table No. 4, p. 1012. These figures do not include emergency expenditures because the objects are not satisfactorily separated out of them.

cause of the relative significance of Personal Services, therefore, rather detailed information is required. The manner in which personnel is reported is based on the Classification Act of 1923 and other special acts and executive orders. Personal services, as a whole, are broken down into professional; subprofessional; clerical, administrative and fiscal; clerical-mechanical; and custodial services. Under each category certain grades have been established and each grade includes certain classes of positions. The schedule of obligations presents, for each class, the number of permanent departmental positions and the average annual salary at base rates of pay. Regular part-time positions are computed in tenths. For example, there may be a class, such as Junior Clerk under Grade 2 in the Clerical Administrative, and Fiscal group, with 6.3 positions at an average annual salary of fourteen hundred and seventy dollars. One person may receive more than that figure but the others will receive correspondingly less. To obtain the total for the class, of course, the number of positions is multiplied by the average annual salary. The sum of these computations for all classes gives the total for all positions. From this gross figure is deducted the amount of savings due or estimated to be due to the non-filling or delays in filling vacancies, to absences without pay, and to the filling of vacancies at lower rates of pay. This gives the net amount for permanent personal services. The expenditures for salaries and wages of miscellaneous temporary employees are then added. From the resulting total is deducted the chargeable value of quarters, subsistence and so forth furnished in kind and the obligations for personal service included in other objects, where work is done on force account. These latter steps ensure that all personal services will be included in one place but also that they will not be counted twice. The whole process yields the amount of 01 Personal Services Net and is presented separately for the departmental and field services.

The remainder of the objects of expenditure are listed under "Other Obligations" on the "green sheet" schedule of obligations. The 02 Supplies and Materials, 06 Travel, and 30 Equipment, for example, are presented at this juncture. Finally a Grand Total Obligations figure is obtained by adding the amounts for each object. Transfers from one appropriation to another are then noted as well as the amounts of prior and subsequent year appropriations obligated in the present year.

The resulting Net Total Obligations figure is adjusted for estimated savings and unobligated balances to give the Total Estimate or Appropriation. This amount, presented on the schedule of obligations, or body, must agree with that presented on the estimate proper, or the head.

In addition to the classification of expenditures by objects the Bureau of the Budget requests that where possible an additional "green sheet" schedule be prepared showing the obligations by projects or functions. The purpose of this is to show what the personal services, supplies, and other objects are being used for.

Just as the head and body of a human being would be incapable of expeditious progress without the aid of legs, so would the estimate proper and the schedule of obligations experience difficulty in travelling through the Budget Bureau without the support of adequate justifications. The third requirement of a good total estimate then is the submission of competent data to explain why the money is needed. Every justification is required to include a statement showing the relation of the estimate to the amount of the appropriation for the fiscal year preceding that for which the estimate is intended. The first line gives the last regular appropriation. To this is added the amounts of any supplemental appropriations for that year. From the total is subtracted such non-recurring items as will not be required in the year for which the estimate is drawn. Thus a basic figure is obtained for the latter year. To this base is then added the proposed increases for the fiscal year in question.

The statement just described, however, is not sufficient for Budget Bureau purposes. Such written statements, tables, maps, charts, and outlines as may be necessary fully to explain and justify the estimates are required in addition. All proposed changes in the language of the appropriation act must be explained and all increases must be justified as listed on the initial statement, either by project, function, or object of expenditure. Wherever units of measurement, statistics, or other objective means of appraising the work are available they should be supplied. The Bureau has made clear that generalized statements of need will not carry much weight.

Besides the estimate proper, the schedule of obligations, and the justifications, certain general statements are required

by act of Congress. All transfers between appropriations, actual or contemplated, for the three fiscal years covered in the budget must be shown. The departments are also required by law to submit a statement with regard to estimates including amounts for the purchase, maintenance, repair, or operation of motor-propelled or horse-drawn passenger carrying vehicles. A statement of printing and binding needs is also specifically called for. The title of the publication, how often printed, average number of pages, number of copies authorized by law, number of copies printed, and the cost, unit and total, are requested in justification of the estimate. Any amounts for printing and binding, including the cost of work produced on the multilith, multigraph, and other similar equipment, which appear in any estimate for any purpose other than the general printing and binding estimate, are set forth in detail in a note following such general estimate. Finally, and at the request of the Budget Bureau, if any supplemental estimates are contemplated for the fiscal year in progress they are listed in a separate statement accompanying the justifications of the estimates.

The estimates, together with the schedule of obligations and the justifications, are transmitted from the department, establishment or agency to the Fiscal Division of the Bureau of the Budget where a record is made of the estimate and the original is retained. This becomes the official copy and is eventually used in printing the budget. The remaining four copies go to the Division of Estimates.

The actual review of the estimates is supervised by an Assistant Director in Charge of Estimates. Under him there are five groups each headed by a Chief Budget Examiner. Each group is, in turn, broken down into three units with a Principal Budget Examiner supervising each.[19] Group I, to take a typical example, is comprised of Unit A, handling the War Department; Unit B, reviewing the estimates of the Navy Department and the Veteran's Administration; and Unit C, examining the expenditure proposals of the State Department and the Tariff Commission. The organization is designed to correspond to major purposes of government expenditure. Group I obviously is concerned with national defense and foreign affairs.

[19] The Chief Budget Examiner is in the salary range $6500-$7500 and the Principal Examiner in the range $5600–$6400.

Upon receipt of the estimates each unit conducts a brief analysis. The department requests are listed by items of appropriation and opposite each is placed the amount which the examiners tentatively decide is needed by the department. This task is usually completed within one week of the submission of the estimates. The Director of the Budget takes these lists, in conjunction with the treasury estimate of probable receipts, which is also submitted on September fifteenth, to the President. A policy is decided upon in a rough sort of way which is a guide to the subsequent action of the Bureau.[20] The Chief Budget Examiners are informed of the decisions of the President and are acquainted with any changes in policy which occur after the initial tentative arrangements.

Following the determination of the general policy, which is the constant to which the variables, the individual department estimates, are referred, hearings are held at which department representatives are quizzed with regard to their proposed expenditures. An individual department's hearings may last from three to six weeks. The estimates for 1938 were subjected to scrutiny in hearings lasting, *in toto*, from September twenty-first to about December seventh. This left time for the printing of the budget document before its submission to Congress on January third. The hearings are arranged by the Principal Budget Examiners, in consultation with their Chiefs, and are scheduled between the hours of 9:30 A.M. and 1 P.M. They are held before a Hearings Committee consisting of the Chief Budget Examiner in charge of the group, the Principal Budget Examiner, to whom the activity has been assigned, and the Assistant Budget Examiner. Frequently the head of a department appears at the first meeting. The Budget Officer and the head of the bureau or division the estimates of which are under fire are always present. These hearings are not public. The Chief Budget Examiner and his aides conduct them on the basis of their study of the estimates, its previous history before the Bureau and in Congress, and their experience with the department in question. The Principal Budget Examiner and his Assistant usually take notes for future reference. In the afternoon, which is held open for the purpose, the Hearings

[20] Up until 1929 the President had announced his over-all policy at the June gathering of officials called the "Business Organization of the Government." This policy was based on preliminary estimates prepared by the Budget Bureau in consultation with the departments.

Committee meets in executive session and "marks" the estimates. That is, all the changes proposed by the Committee are made on the copy of the estimate retained by the Principal Budget Examiner. The Committee then prepares a brief record of its conclusions, including the reasons therefor, for the use of the Board of Review. All changes in the language of last year's appropriation act are then reviewed by the Senior Attorney of the Bureau of the Budget.

After the Assistant Director in Charge of Estimates has reviewed the work of the Hearings Committee, a meeting is arranged with the Board of Review by the Administrative Assistant to the Director. The Board is composed of the Director, the Assistant Director, and the Assistant Director in Charge of Legislative Reference. The Hearings Committee must justify its action before this superior review body. This amounts to a double check on the departments and also permits a broader approach in terms of administrative policy. The Board of Review not only goes over the detail which has been thoroughly considered by the Hearings Committee but also is in a position to compare one department or service with another, to determine the relative urgencies of their requests for increased expenditures. The Director, of course, is the person responsible to the President and he initials the "official" set of estimates which emerges from the hearings before the Board of Review.

When the Director has made his final decisions, two tabular statements are prepared. One has nine columns including respectively: the item number, appropriation title, actual obligations last completed fiscal year, appropriations for the year in progress, the estimate for the ensuing fiscal year as submitted by the department, the estimate allowed by the Budget Bureau, changes by the President, increase or decrease of the budget allowance as compared with the department estimate, and increase or decrease of the budget allowance compared with the appropriation for the year in progress. The statement shows the totals for bureaus and services. The second table includes the item number, appropriation title, a brief explanation of the increase or decrease of the Budget Bureau allowance as compared with the department estimate, and a brief explanation of the budget allowance as compared with the present appropriation. The Director takes these tables to the White House and goes over them with the President. The chief exe-

cutive makes such changes as he thinks advisable in the column reserved for that purpose. These tables are returned to the Hearings Committee with directions to correct the "official" set of estimates so as to accord with the alterations indicated by the President. Any further last minute changes must be specifically approved by the Director on the "official" set of estimates.

The final word of the President having been obtained, a letter is despatched to the department or establishment head informing him of the total allowed, the amount under each appropriation heading, and the changes approved in the text of the appropriation. The Chief Budget Examiner either instructs the department budget officer to revise the schedule of obligations held by the Fiscal Division or transmits to the department head a set of corrected estimate sheets and requests that a corrected schedule of obligations be submitted. A final appeal is the prerogative of the department. This may reach as far back as the President if the matter is an urgent one. When these final adjustments have been made the budget is ready for the printer and for Congress.

The process through which the estimates pass in their progress from the department to Congress has been outlined. Certain features of this process stand out as more significant than others for the purpose of the formulation of a financial program. It is proposed to select two of these for more intensive analysis. The forms in which information is brought to the Bureau are significant inasmuch as they are the basis for the hearings. The hearings themselves are vitally important because it is at that point that policy decisions already made by the President are translated into specific programs and where facts are gathered for further decisions as to how much a department is to get absolutely and in relation to all other departments.

THE ESTIMATE PROPER

The essential forms in which the typical estimate is embodied we have seen to be three: the estimate proper, the schedule of obligations, and the justifications. In terms of the analogy to the human anatomy previously found useful in distinguishing them, they may be termed respectively, the head, the body, and the legs. The function of the estimate proper is to provide clear legal authority for the expenditure of money. This would

seem to be a relatively easy matter but it is, in fact, a complicated one. The reason is that Congress has seen fit to hedge the expenditure of public funds about with numerous restraints. Thus specific legal authority must be obtained before money can be expended for salaries and rent in the District of Columbia, newspapers in excess of one hundred dollars, periodicals, land, passenger-carrying vehicles and so on. If the original act setting up the activity failed to cover these items, they have to be provided for in the language of the appropriation act each year. The Social Security Act, for example, was not well drafted in this respect and consequently a host of legal phrases must be included in each annual appropriation act. The Budget Bureau examines the language in the estimate proper, therefore, to assure the agency of legal authority to spend for its needs. By suitable insertions it is also possible, at this point, to provide for slight extensions of the enabling act, for instance to require the posting of bonds. Appropriate language is important for control purposes, for bridging the gaps in substantive legislation, and for meeting certain rigid requirements laid down by Congress. Only if the language is clear and inclusive will the Treasury and the General Accounting Office issue and countersign, respectively, the warrants which are essential for obtaining the funds with which to carry on the activities for which the agency was designed.

The result of these specific restraining statutes, and the failure of many enabling acts to meet them once and for all, is a mass of detailed legislation repeated year after year. It has been said that detailed legislation is the American way. If so, it is certainly a confusing and unwieldy way. There is no uniformity among agencies as to the character of the expenditures authorized for each or as to the text of appropriation paragraphs that do authorize the same kind of expenditures. The Budget Bureau has sought to bring some sort of order out of this chaos. It should continue to seek to insure that enabling acts contain the requisite authority to spend. This will obviate the necessity for cluttering the appropriation acts with a mass of detail. The budget document will then be less bulky and more intelligible and the *Digest of Appropriations* will become the informative source that it should be rather than remaining the nightmare of legal phraseology that it is.

Not only are the individual items of appropriation, the

"heads" of the estimates considered by the Budget Bureau, too encumbered with legal restrictions which belong elsewhere if they are justified at all, but there are too many appropriation items. This raises the question of detailed item versus lump sum appropriations.[21] In the one case the legislature votes money by relatively small amounts to specific projects or duties while in the other a relatively large sum is given to an administrator for certain purposes. He may then, in his discretion, shift funds from one point to another so as best to meet the needs of his program as a whole. There is evidently no principle upon which Congress decides to employ the lump sum rather than the detailed item. As a result there is no consistency in the budget or in the appropriation acts. The Veteran's Administration for 1939 has nine appropriations totalling approximately six hundred and forty-eight million dollars. The Bureau of Indian Affairs has three hundred and ninety appropriations amounting in the aggregate to about thirty-three million dollars.[22] Some departments receive lump sum appropriations for certain purposes while others are forced to expend funds for similar operations under the rigid provisions of itemized appropriations. The Departments of Commerce, Labor, and Justice each have a lump sum amount for travel expense while the other departments have segregated items for each bureau, division, or section. The reason for this disparity of treatment is partly political. By means of itemized appropriations the Congressmen can be sure that there will be provision for their pet projects. There is no danger of the money being diverted by some administrator.

While political expediency has thus been partly responsible for the chaotic condition of the appropriation structure, it should be pointed out that the fundamental question of legislative versus administrative or executive control is also involved. As one authority has stated: ". . . the greater the number of votes (items of appropriation) the closer the control; while the fewer the votes the more free are the hands of the department."[23] In the United States the popularity of the

[21] This problem has been with us since the establishment of the government. See A. Gallatin, *A Sketch of the Finances of the United States* (New York: William Davis, 1796), p. 81.

[22] *1939 Budget*, pp. 108 ff. and 363 ff., respectively.

[23] A. J. V. Durell, *The Principles and Practice of the System of Control Over Parliamentary Grants*, p. 279.

so-called separation of powers theory has accentuated the difficulties of the situation since the power of the purse has been allotted to the legislature. There has been a difference of opinion as to how far Congress can go in appropriating large unearmarked amounts without relinquishing its essential authority. It is asserted by one school that Congress as the fund-granting and fund-raising body should keep a close check on expenditure and that lump sum appropriations make this impossible. The other school maintains that the executive cannot fulfill his function of the execution of the laws unless he is provided with the flexibility and the opportunity to exercise administrative discretion which are inherent in lump sum appropriations. There has been no clear adherence to either view in the budget itself. This is perhaps to be expected since it can logically be argued that in a great variety of undertakings there will be some which are properly subject to close legislative control and others which by their nature call for the exercise of administrative discretion. The point is, however, that there has been no consistency in treating functions of the same order. Two or more departments may have functions of the same nature but one is left a certain freedom in expenditure, as far as Congress is concerned, while the other is subject to strict control.

Congress had, up to 1929, done little to improve the appropriation structure.[24] Since that time some progress has been made by the House Appropriations Committee. The Bureau of Standards, for example, had its twenty-nine items compressed into four.[25] An obstacle to substantial revision, however, has been a legislative disinclination to disturb the *status quo*. The committees of Congress dislike to see the presentation of the budget change from year to year. They like to find an appropriation item in its accustomed place. This factor is linked to the control aspect already discussed. A detailed item occupying the same place in the budget year after year can be watched.

This feeling on the part of the legislature stems, in part, from a lack of confidence in administrative controls as well as from theoretical and political sources. This was particularly true

[24] A. E. Buck, *Public Budgeting* (New York: Harper and Bros., 1929) p. 131.

[25] 74th Cong., 2nd Sess., House of Representatives, *Hearings before the Subcommittee of the House Committee on Appropriations in Charge of the Departments of State, Justice, Commerce and Labor Appropriations Bills for 1937* (Washington: Government Printing Office, 1936), p. 127.

before 1921.[26] Since that date the establishment of the Bureau of the Budget and the General Accounting Office has resulted in a tremendous improvement in control. There is still much that could be done by the executive branch, however, to put its house in order in this respect. The system of apportioning appropriated funds by months and requiring monthly statements of obligations by appropriations has not proved satisfactory.[27] There is, therefore, a good deal that can be done by the executive branch. This does not alter the fact that the Congress has as yet made little adjustment of the appropriation structure in response to the development of administrative controls during the past decade.

A consideration of the various factors involved, therefore, reveals that a revamping of our appropriation structure is long overdue. Not only are the present acts burdened with a mass of needless detail but there is also, in many cases, an irrational use of the lump sum and the detailed item.[28] The President has suggested that a special joint committee of Congress be established to study the appropriation item situation.[29] Nothing has publicly resulted, however, from his recommendation. It may be that the initial action should be taken by the Budget Bureau in coöperation with the departments. Authority for such a step is certainly contained in the Budget and Accounting Act.[30] These experts, however, should work in close collaboration with the Appropriations Committees of Congress. Experience has shown the folly, and perhaps the impropriety, of handing a finished product to Congress and expecting it to coöperate. Aside from all such questions of policy, there is the fact that the clerks of these Committees, and many of the members, are experts on the subject of appropriations and valuable advice would be obtained from them. The legislature, therefore, should be asked to participate in the study. The final result, ideally, would produce some lump sum and some segregated items but, more important, a certain consistency of

[26] W. F. Willoughby, *The Problem of a National Budget* (New York: D. Appleton and Co., 1918), p. 118.

[27] A. E. Buck, *Fiscal Management in the National Government: a study submitted to the President's Committee on Administrative Management* (Washington: Government Printing Office, 1937), p. 17. Steps taken under Executive Order 8512 (Aug. 13, 1940) would greatly improve this system of financial reporting.

[28] Such problems as the disposition of permanent appropriations not dealt with in the act of June 26, 1934 (48 Stat. 1224) also press for a solution.

[29] Budget Message of Franklin D. Roosevelt, January 3, 1935.

[30] Sec. 209.

treatment of services of the same nature. Congress should, if approached by the Budget Bureau, appreciate the insight of the able French authority who wrote

> The legislature, as we have mentioned time and time again, possesses incontestably the right to vote the public revenues and expenditures. But if this right, through a fatal logic should be carried to its extreme limit . . . the vote would go as far as the items. . . . The Chambers, as a result, would be compelled to turn executives in order perfectly to control the administrations.[31]

THE CLASSIFICATION OF EXPENDITURES

It is a matter of importance for the administrative control of expenditures to have appropriations of a manageable size for which legal authority is clearly established. It is just as important to have a plan of each such appropriation which indicates how the money is to be spent. The schedule of obligations, or body of the estimate, is intended to fulfill that function. Theoretically the budget should combine the features of a financial report and a financial plan. The schedule of obligations attempts to meet this requirement by presenting the actual expenditures for the last completed fiscal year, a figure for the year in progress which is part estimate and part fact, and a proposal for the expenditures of the year to come. Attention has already been called to the fact that the "green sheets" are based upon a classification of objects of expenditure listed under certain character headings, such as "Current Expenses" and "Fixed Charges."[32] An intensified breakdown of this type is valuable as an instrument of control yet does not introduce the rigidity which an itemized appropriation does. The reason is that the schedule of obligations is included in the budget but it is not enacted into law. It lends itself to administrative control in that it provides a basis for questioning at budget hearings and permits comparison of different organizations or of the same organization over a period of time. Since the Appropriations Committees of Congress have access to the "green sheet" information, a basis for legislative control is also furnished. The vital point, however, is that the schedule is not enacted into law whereas the estimate proper is embodied in

[31] René Stourm, *The Budget* (New York: D. Appleton and Co., 1917), p. 303.
[32] The theory and practice of classification for budget purposes is well set forth in Buck, *op. cit.*, pp. 181 ff.

the appropriation act and cannot be changed. In the first case there is a possibility, therefore, of controlled adjustments between the objects of expenditure after the appropriation act is passed.

The "green sheets," as at present used, contain a great deal of information about personnel. This has been described in that part of the paper dealing with the mechanics of the budget process. The inclusion of this detail makes the estimates submitted by the departments to the Budget Bureau very bulky and constitutes an estimated one-third of the budget document itself. Questions have been raised as to the utility of this mass of material and the opinion has been expressed that a more readable and understandable document might be obtained, without sacrificing essential control, if the "green sheet" schedules of obligations were simplified with regard to the personnel aspects.

Personnel, however, is but one object of expenditure. The complete object classification for the federal government was formulated in 1922 and revised in 1927.[33] The decade or more that has elapsed since that date has given rise to conditions and problems that would seem to dictate a further overhauling. New objects of expenditure are constantly cropping up and it is frequently necessary for a spending unit to go to the General Accounting Office to obtain an accounting symbol for the new item. The present printed classification is not, therefore, all-inclusive. But even in the case of included objects there is confusion due to vague definitions. Gasoline, for example, is extensively used by a large department for stationary engines and for trucks and automobiles. In terms of the object classification, therefore, it can be listed under either Supplies and Materials, or Travel. Under existing conditions the money can be diverted from one use to the other practically without restraint. Certain automobile expenses are liable to appear under either Supplies and Materials or Storage and Care. Again there is a question whether stenographic services should be classified under Printing and Binding as is now the case. In such circumstances effective control is frequently impossible. The object classification, therefore, requires an extensive overhauling. Such a revision will be by no means an easy task. Some of the difficulties are inherent in an object classification as the variety of systems

[33] General Accounting Office, *Bulletin No. 1.*

proposed and in use testify. The distinction between supplies and equipment, for instance, is usually drawn yet has occasioned a great deal of argument. It should be possible, nevertheless, to define an object clearly enough to prevent such evasions as now take place. A classification by objects is absolutely necessary to secure uniformity in the recording and reporting of expenditures and to permit analysis of the expenses of any organization or activity in terms of the application of human effort and the consumption of materials. The Budget Bureau, now that its staff is being increased, should take up as a research project the revision of the object classification.[34] The General Accounting Office would probably acquiesce in such an endeavor. Men of experience, aided by good research specialists, should go right into the departments in an effort to work out a more satisfactory classification. The more complete and accurate is the information presented in the schedule of obligations, the better is the basis established for effective administrative and legislative control.

Even if a perfect object classification could be produced, however, the classification problem as a whole would not be solved. Merely to state that so much had been spent by an organization for Personal Services, so much for Travel, and so much for Equipment would not satisfy the requirements either of control or information. There would be difficulty, for example, in determining how much had been spent for the current running expenses of the government and how much for durable improvements. Information of this type is not adequately provided now.

> The significance of expenditure classification is disregarded in the budget, which presents only the expenditure details according to the organization units, that is, the departments and their subdivisions. . . . The inadequacy of the expenditure classification prevents anyone from discovering, for himself, the exact situation.[35]

Not only is the individual without the information which he needs for a judgment on the fiscal policies of the government,

[34] Budget Director Smith recently announced his intention of pursuing a study of expenditure classification. 76th Cong., 3rd Sess., *Hearing before the Subcommittee of the House Committee on Appropriations in Charge of the Independent Offices Appropriation Bill for 1941* (Washington: Government Printing Office, 1940), p. 5.

[35] H. L. Lutz, "Budgets, Bonds, and Ballots," in *Facing the Facts* (New York: G. P. Putnam, 1932), pp. 41-42.

but the President and Congress do not have the data they need for formulating policy and the administrator lacks the necessary data for controlling the execution of policy decisions. Some knowledge as to the character of an expenditure, whether for current or capital outlay, and the function for which it was made are desirable for purposes of intelligent budget formulation and control.

The existing object classification, it is true, is arranged under the character heads: Current Expenses, Fixed Charges, Acquisition of Property, Payment of Debt, and Capital Outlay for Rights and Obligations. The difficulty here is that an object often cannot be placed once and for all in one category. The purchase of a truck, for example, might conceivably be either a current expense or an investment. If the Post Office were buying the truck to replace one of the fleet used in its daily routine, the expenditure might well be termed a current one. If a small agency or office were obtaining a truck for the first time in order to expand the scope of its services, the expenditure might be called an investment. The existing classification would require the truck to be listed under Equipment and it would be termed an Acquisition of Property regardless of its use.

There is no clear reason, moreover, why land and structures could not be included under Capital Outlay along with rights and obligations. Some governments include Debt Redemption under Capital Outlays but this is a doubtful practice unless all long term bonds have been issued for capital improvements. At any rate there is a question whether the federal government's five-fold character classification is the best that could be devised. And there is also the problem as to whether it can properly be superimposed on the object classification. There is no doubt but that the two types of classification can be used together but whether all object categories can be definitely and permanently assigned to character classes is another question.

A final criticism of the character classification now existing is that it is not used in the budget, except in an informational table which becomes somewhat meaningless in the light of the foregoing discussion. The people, and even the financial experts, of this country have little inkling of the extent of public investment involved in each annual budget. Nor does the existing classification serve as an index to the method to be used in financing, which is supposed to be one of the main pur-

poses of the character classification in budgeting. A classification of this type would aid in policy determination and would be especially helpful if some sort of investment budget were adopted. The problems in this regard are discussed in the paper on the investment budget which is included in this volume.[36] But regardless of the method of presenting the budget, the character classification is necessary to give adequate information on expenditures. First we must determine what type of things have been purchased. Afterwards a separate decision is involved when we determine, as a matter of policy, what purchases must be met out of current revenue. In other words, the problems of expenditure classification and budget balance are related but not inseparable.

But even a sound character classification tied to a revised object classification would not complete the necessary classification structure. The grouping of expenditures according to function or activity is generally recognized as a fundamental of good expenditure classification. The federal government uses a classification of functions into general, military, civil, and nonfunctional. This is very broad, however, and does not provide information on how much is being spent for education, public health, and so on. Neither is it coördinated with the object classification. Whether a uniform functional classification could be developed for the federal government which could be related to the other bases of classification and made to serve useful purposes of information and control is problematical. An accurate answer could only be given, possibly, after a careful scrutiny of all federal expenditures by a committee of experts. There is no doubt but that such a study would be useful for preparing plans for reorganizing the federal administration.[37]

The schedule of obligations, or "green sheet," used in federal budgeting does call for a breakdown of departmental expenditures by projects or activities. This is quite different from a functional classification applied to the government as a whole and involves a somewhat narrower definition of "function." The significance of such an intradepartmental "functional" classification has been questioned.[38] The experience with it in the federal government, however, has led to enthusiastic en-

[36] See the article in this volume by Spencer Thompson on "The Investment Budget," pps. 63–77.

[37] Buck, *op. cit.*, p. 186.

[38] *Ibid*, p. 187.

dorsement by department and Budget Bureau officials alike. The functional or project classification has been used with a considerable flexibility which has recognized that not all appropriations are adapted to such a method of presentation. In the Department of Agriculture, for example, the project classification is the real basis for the consideration of the estimates. The reason is found in the prevalence of a variety of functions carried on under lump sum appropriations. Other departments and agencies are either nearly unifunctional or detailed items of appropriation make difficult the use of the project or functional classification. For them the object classification must be the primary basis for the consideration of the estimates. The virtue of the project classification is that it starts the discussion of the estimates off on a higher plane. The question of whether a project should be undertaken at all, or, if it has already been launched, whether it should be continued and, if so, at what rate, is considered first. "Budgetary documents prefaced on a program and project basis tend to direct attention to program objectives and away from possible professional or departmental boarding-house reaches."[39] By considering work programs first the fundamentals are agreed upon before the objects of expenditure, such as whether two senior economists or six are needed, are taken up. For these reasons the project or functional classification has been termed the most informative feature of the budget.

The relationship of the various types of expenditure classification should be kept clear. The use of one or two does not necessarily exclude the others.[40] At present the federal budget data are presented by organization unit as the main type of classification. This is done in order to attach responsibility to a specific person, the head of the organization. Following each organization title are the details of the expenditures by objects and, in appropriate instances, by projects or functions. The object and functional breakdown has worked well, for example, with regard to the Departments of Commerce and Labor. The broad functional classification—general, military, civil, and

[39] J. B. Blandford Jr., "Coordinating Administration," *Governmental Research and Citizen Control of Government*, Proceedings of the 28th Conference, Governmental Research Association, September 1939 (Detroit: Governmental Research Association, January 1940), p. 98.

[40] W. Kilpatrick, "The Classification and Measurement of Public Expenditures," *Annals of the American Academy of Political and Social Science*, vol. CLXXXIII (January 1938), p. 19.

non-functional—and the fund classification—general, special, and trust funds—complete the types of classification found in the United States budget. They are not used, however, with any general consistency or pattern. The result is an exceedingly intricate document. A former Congressman and successful business man stated that: "The budget itself is an enormously complicated thing. Outside the budget director and a few assistants, I do not believe anyone has a broad grasp of the whole picture."[41] Nor is this a voice crying in the wilderness. There have been many appeals for a clearer presentation of budgetary information. The reorganized Budget Bureau should adopt as one of its primary duties the development of an expenditure classification structure which will show the organization units spending money, the functions carried on, the extent to which expenditure is devoted to current and other outlays, the objects of expenditure, and the funds from which the money is taken. Surely a greater clarity can be introduced into the budget so that at least a well-informed person, let alone the man in the street, can derive some benefit from a study of it. As matters stand, only a few experts can interpret the maze of apparently unrelated figures.

THE JUSTIFICATION OF BUDGET ESTIMATES

Regardless, however, of the excellence of the expenditure classifications in terms of which the departments might submit their estimates of appropriation to the Budget Bureau, further information with regard to those estimates would be necessary for an adequate review. On the basis of authority contained in its constituent act the Bureau of the Budget has, therefore, asked the departments and establishments to submit justifications of their estimates of appropriation.[42] These justifications are what have been termed in this paper the legs of the estimate. They put the burden of proof upon the spender. The Bureau insists on respectable support for a proposed expenditure. It has been estimated, however, that at least 25 per cent of the justifications fall short of the Bureau expectations. For justification purposes a mere statement of need will not suffice. First the base must be established, as explained in the section

[41] J. B. Hollister, "Discussion: The National Budget of the United States," *Proceedings of the Academy of Political Science*, vol. XVII (January 1938), p. 53.
[42] Secs. 213 and 216 of the Budget and Accounting Act of 1921.

on budget mechanics, and then the increases explained. The explanation may be in terms either of functions or of objects of expenditure. Wherever possible concrete data are demanded in support of the estimate. A poor justification will prejudice the case of the spending agency. For instance, one project involved the production of alcohol from surplus agricultural products. In justification it was claimed that the resulting product could be used in gasoline to end deaths by carbon monoxide. The farmer, it was claimed, would also be aided. No data was given as to the cost of the alcohol produced by this method and, needless to say, the "justification" carried very little weight.

The Budget Bureau is continuously striving to get the departments and establishments to improve their justifications. Brevity and pointedness are emphasized. Where several functional organization units operate under one lump sum appropriation the Budget Bureau has asked that the justification be made by organization unit. In spite of this effort to make them as objective as possible, long and argumentative justifications are frequently sent in. Sporadic attempts have been made to correct this situation by calling in the departmental budget officers and explaining just what was wanted in the way of justification. Part of the fault may lie in the fact that many budget officers have never seen a good justification and do not know how to go about preparing one. The Bureau, in its annual circular calling for the estimates, gives an example of how the base figure is to be reached—by taking the last appropriation, adding supplemental appropriations during the year, and subtracting non-recurring items. But no sample of the textual justification is provided. The use of a model justification might help to demonstrate what is wanted. If more budget improvement committees, similar to the one now operating in the Treasury Department, were established in the departments and agencies, they might function as a medium for education with respect to justifications as well as for improving the consideration given to departmental estimates before they reach the Budget Bureau. Now that the Division of Estimates staff has been increased, moreover, more time will be available for discussing this problem with the department budget officers. Assistance can be given in determining the type of information the Budget Bureau needs and how it can be obtained. Especially helpful would be the stimulation of the creation of work units

and the development of criteria for the analysis of the departments' programs.

THE OVER-ALL REVIEW OF THE ESTIMATES

The institution of the forms which will best set forth the expenditure needs of the organization units and the education of budget officers so that they may make efficient use of the forms are basic preliminaries to the all-important step of careful and painstaking review of the estimates of each department in itself and in relation to those of all other departments. The Budget Bureau, as has been pointed out, has established a twofold review, by the Hearings Committee and by the Board of Review. It is at this juncture that the needs of the individual units are reconciled with the general policy of the chief executive. The President has by this time decided on many questions of broad policy and has communicated his decisions to the Budget Director. The need for increased expenditures due to increased social demands has been discussed. Whether expenditures should be cut because of falling revenues or an improvement in the business situation has been decided. The Chief Budget Examiners are kept advised of these policy decisions and are able to shape their questions and actions accordingly. An over-all view thus tends to influence the treatment of the individual agencies and departments. The importance of this is indicated by a reference to the situation which existed prior to the establishment of the Budget Bureau. "The absence in the past of any authority thinking in terms of the common interests of the government as a whole has involved the United States Government in hundreds of millions of dollars of unnecessary loss."[43]

One task of the Budget Bureau in exercising an over-all point of view is to see that the total of the departmental estimates does not exceed the figure established as a matter of policy by the President. It is common knowledge that the estimates coming up for review tend to be inflated. In the past, before the passage of the Budget and Accounting Act, an inflation of 40 per cent was by no means unknown.[44] After the United

[43] Director of the Budget, *Annual Report*, December 5, 1921, as printed in the *Alternative Budget for 1923* (Washington: Government Printing Office, 1921), p. xl.
[44] R. Smoot, "Reforms in the Federal Government," *Proceedings of the Academy of Political Science*, vol. IX (1921), p. 435.

States had followed the rest of the civilized world in establishing a budget system, the evil of purposely excessive estimates was mitigated to a great degree. Mr. Madden, Chairman of the Appropriations Committee of the House of Representatives, declared that: "In my experience as a legislator I have never seen estimates of appropriation so free from obvious padding, so carefully squared to actual needs, or so void of proposed extravagant expansion as these. . . ."[45] This gentleman was one of the fathers of the budget system and hence may have been expected to take a favorable view. It will not be going too far to state, however, that most competent observers agree that the Budget Bureau has substantially discouraged the habit of deliberately increasing an estimate in expectation of reductions. The fact that the total of departmental expenditure estimates, as at first submitted, still far outruns any figure remotely within the bounds of possibility, may now be attributed more to expanding government functions and to the enthusiasm of individual administrators than to conscious efforts to outwit the Budget Bureau and Congress. There are exceptions, of course. The feeling that the primary function of the budget officer is to "get the money" still prevails in some quarters. But the more enlightened budget officers, and the most successful before the Budget Bureau, while realizing that they are necessarily cast in the role of advocates, believe that it is possible to combine loyalty to their departments with coöperation with the Budget Bureau.[46] The fact that the individual administrator has only his own needs to consider also causes him to feel that he should have more money. The Budget Bureau tries to provide the necessary over-all view. More and more the departments are coming to realize that the President was right when he said, concerning the relation of the Director of the Budget to them, that: "If you think he can not see the details of each department as you see them, you must remember that you cannot see the requirements of the whole government as he sees them."[47]

In attempting to apply this over-all view the Budget Bureau is faced with the problem of the relative merits of different

[45] Quoted in W. F. Willoughby, *The National Budget System*, p. 288.
[46] W. A. Jump, *Budgetary and Financial Administration in an Operating Department of the Federal Government*.
[47] *Address at the Sixth Regular Meeting of the Business Organization of the Government*, January 21, 1924 (Washington: Government Printing Office, 1924), p. 4.

types of expenditure. Upon the President, of course, rests responsibility for the final decision but the Bureau unearths facts which may form the basis for the decision. The problem may be one of trying to find areas where reductions may be made in order to bring the total of the budget within a designated figure. The Budget Bureau experts, with their intimate knowledge of the departments, will then search the estimates with a fine-tooth comb. Certain items can be cut within each department but the time will probably come when items of one department are compared with items of another. In such a situation it is almost impossible to decide objectively to recommend that the forest experiment station be eliminated rather than the Coast Guard station. In spite of these difficulties there has been a great improvement over the pre-1921 days when the department estimates went to Congress without any coördinating review.

THE REVIEW OF SPECIFIC DEPARTMENTAL ESTIMATES

The basis for the over-all review of the departmental estimates is the hearings on the estimates of each individual department. A more intensive analysis of the estimate examination will reveal the extent of the control exercised. These hearings are conducted on an informal basis. There are only a half dozen or so men present and there is no stereotyped pattern. Important but elusive factors are the personalities involved and the relationships of past years. It is difficult, therefore, to reduce an analysis of the process to objective terms. One way to test the value of these hearings, however, is to attempt to determine whether the right questions are asked. If a sincere effort is made to elicit basic facts through a series of coördinated and pointed questions then there is some evidence that the hearings are an aid to effective budget formulation.

Fortunately there is available a digest of the typical questions asked at the Budget Bureau hearings.[48] Not all of them are posed at any given hearing but they represent, in general, the current approach to the problem of estimate examination. In analyzing the justifications, which have been identified as

[48] Prepared by F. J. Bailey, Assistant Director in Charge of Legislative Reference of the Bureau of the Budget, and W. A. Jump, Budget Officer of the Department of Agriculture, for their course in Federal Budgeting given at the American University School of Public Affairs, Washington, D. C.

the legs of an estimate, it is first demanded what it is the agency wishes to do, why, and how it will be done. In probing into the matter further, the budget examiners seek to determine whether the purpose is clearly a proper federal concern rather than a state, county, municipal, or private one. The questioners ascertain whether the expenditure is authorized by substantive law. If the money is sought for the purpose of expanding an existing activity, an analysis is made of what is being done at the present time. The possibilities of accomplishing the desired objective through a revision of the existing program are explored. Inquiry is made as to whether the activity is a legitimate one for the agency requesting the funds or whether it comes within the jurisdiction of some other federal agency. Careful consideration is given to the question of whether the proposed activity overlaps or duplicates any existing activity. If the work proposed is related to programs carried on by another agency, the budget examiners ask whether the two agencies have coordinated their efforts. The inquisitors then require a supportable explanation of how the estimated amounts are determined. If the estimate is one subject to quantitative analysis, the justification must contain the applicable figures. Cost criteria, statistics, or other media of measurement are requested. The examiners ask whether alternative ways and means of attaining the objective have been considered and found to be undesirable or impractical. Inquiry is also made as to possible fees or receipts and the contemplated disposition thereof. Finally local or other geographic aspects are considered.

The schedule of obligations, or body of the estimate, is subject to a more detailed scrutiny. The examination of the justifications settles the fundamental problem of whether the proposal is in accord with the President's program and is otherwise worth-while. With agreement on the ends, the means are next considered. The schedule of obligations should reveal how many men and how much material will be needed for the work under consideration. Here also the questions asked at the budget hearings follow a general pattern.[49] Personnel, as has been indicated, is the largest single object of expenditure. Great care is exercised, therefore, in scrutinizing the manner in which the money allotted to personal services is spread over the var-

[49] Once more we are indebted to F. J. Bailey and W. A. Jump for indicating the essential questions.

ious grades. New positions must carry a salary which is at the entrance of the grade in which they are located. Adequate explanation must be made as to the possibility of new positions not being filled immediately and hence not requiring an estimate on a full twelve months' basis. In addition an estimate must be included for existing positions which may be unoccupied for part of the year. An effort is made to gauge the general reasonableness of the personnel set-up by asking for the average salary per capita. Total permanent salaries for the agency are divided by the total number of annual employments. Any large force that exceeds sixteen hundred to two thousand dollars per annum requires special defense. The changes, over the three-year period covered in the estimates, in average salaries in each grade, are examined. Questions are asked about the ratio of positions in the higher brackets to those in the middle or lower brackets. The theory is that by and large a certain number of executives require approximately a certain number of stenographers and messengers. The additional positions requested are explored to determine whether they check with the reasons given for increased funds in the justifications. Inquiry is made as to whether any of the types of positions are unusual for the agency under examination. This question is designed to check, for example, on lawyers assigned to an operating division of a bureau with a separate legal division. The examiners inquire into whether deductions are shown for perquisites furnished and for amounts included in other objects of expenditure. Amounts scheduled for temporary employees must be explained and a factual basis must be provided for contemplated promotions.

Amounts estimated for Other Objects of expenditure, as shown on the schedule of obligations, evidently receive a less rigorous examination than the personnel plans. The budget examiners request that the amount estimated for supplies be defended on a per capita or other appropriate basis. The funds for travel are checked against the number of employees who travel and the extent of their trips. Estimates for construction or equipment are examined to determine whether they reflect the addition or subtraction of non-recurring items involving one year only of the three years shown on the schedule of obligations. Expenditures for the purchase and operation of motor vehicles are questioned closely due to the interest of Congress in such items. Any material increases or decreases in any object

must be explained. The examiners also attempt to check on whether money granted for certain objects at past hearings has actually been spent for those objects.

An analysis of these questions reveals that, in general, they are well designed to elicit the facts and information upon which an intelligent decision may be based. The queries, however, also indicate certain weaknesses. The questions tend to ignore the factor of superannuation in government. The examining process is admirably designed to force a justification of increases in the estimates or new estimates but there is a tendency to assume that if an activity was justified in spending a certain amount last year or the year before, it is entitled to at least the same sum this year. A second shortcoming of the hearings process lies in the lack of sufficient criteria to use as standards for measuring the effectiveness of administrative operation and the need for additional funds. In the third place, although the questions asked may be excellent, there is difficulty in determining whether the answers are satisfactory. This problem reveals the need for the study of departmental programs in the field and for management research to aid in determining the efficiency and economy of organization and procedure. These three criticisms will be taken up in turn.

THE PROBLEM OF SUPERANNUATION

The problem of superannuation is raised by agencies whose functions are on the wane and are, therefore, subject to budgetary cuts. To reduce the expenditures of a government agency, the functions of which may continue to be important to special interest groups even though they are becoming relatively less consequential to the country as a whole, is a difficult proposition. Director of the Budget Lord recognized this when he said:

> There is never hope of completing a project or abandoning it for some new activity of greater importance and promise. Like Tennyson's brook, the old job goes on forever. I am convinced we are carrying on work on which we have spent and are spending good Government money with little or nothing to show for the expenditure.[50]

[50] *Address at the Eleventh Regular Meeting of the Business Organization of the Government,* June 21, 1926 (Washington: Government Printing Office, 1926), p. 16.

The problem is by no means indigenous to the United States. England has recognized it and has taken steps to guard against it. "It is the duty of the Treasury to familiarize itself as far as possible with the needs of the several departments and to effect reductions as well as to check increases."[51]

The very nature of the forms used by the federal Budget Bureau tends to demonstrate that insufficient emphasis is placed on justifying the existing level of expenditure. The schedules of obligations call for data on the last completed fiscal year, the year in progress and the year to come. These figures, presented in parallel columns, lead the examiners to compare the estimate with the actual expenditures for the last completed fiscal year. The justifications analysis, as has been shown, relies on the establishment of a base and then the examination of amounts proposed in excess of that base. Attention, therefore, is directed chiefly to items that tend to grow in size. The Budget Bureau is cognizant of the problem but until recently had done little about it. The solution is linked to the subject of field studies and management research. As former Acting Director Bell stated:

> When the need for government activity along a certain line declines, the agency concerned generally finds some means of continuing that activity as fully as before, and will be likely to continue to so continue it unless there is an agency of Government charged with the continuous duty of studying the Federal structure to prevent such superannuation.[52]

We shall, therefore, defer further discussion of the problem to the time when the need for such study is taken up as a point in itself.

THE NEED FOR OBJECTIVE CRITERIA

The second criticism of the hearings process was that objective criteria for use in analyzing expenditure requests have apparently not been fully developed. In this field, for example,

[51] W. F. Willoughby, W. W. Willoughby, and S. M. Lindsay, *The System of Financial Administration in Great Britain* (New York: D. Appleton and Co., 1917), p. 65.

[52] 75th Cong., 3rd Sess., House of Representatives, *Hearing before the Subcommittee of the Committee on Appropriations in Charge of Deficiency Appropriations on the Second Deficiency Bill for 1936* (Washington: Government Printing Office, 1936), p. 741.

the federal government is far behind local government. The spending agencies should be made to correlate the amount of money spent, or to be spent, with the amount and quality of work done or to be done. "Expenditure control must rest upon something more substantial than guess-work, even when this is officially done."[53] It must not be inferred that the Budget Bureau has done nothing in the field of objective criteria. General Lord had, as Director, a considerable interest in the subject. Individual budget examiners have worked out modes of measurement for their specific agencies. The use of a personnel ratio, relating the total spent for salaries to the number of persons employed, has been mentioned. In like manner such measures as the number of beds, the ratio of nurses and attendants to inmates, and the daily average number of patients have been employed in analyzing the estimates of hospitals. In the case of reproductive work, such as multigraphing, standard production units have been worked out and applied to requests for funds. Until recently, however, efforts at developing criteria have been sporadic and restricted to the few most obvious areas of applicability. The Budget Bureau now intends to use part of its expanded staff for the purpose of developing standards in a more extensive and systematic manner. Both the Estimates Division and the Administrative Management Division will be active on this front.

THE NEED FOR FIELD CONTACTS AND RESEARCH

The third criticism of the hearings process was that although the right questions might be asked there has been no way of determining the accuracy and validity of the answers. In the past, chief reliance was placed upon the experience and knowledge of the individual budget examiners. The following exchange between a Congressman and a Budget Bureau representative illustrates this:

Representative Johnson: "You take their statements and if they say they need so much money you say they do not. How do you get at the real facts of the case as to how much money they really need? It is your opinion is it not?"

Mr. Lawton: "It is an opinion, based on experience. For example, the Assistant to the Director who handles the War Department

[53] H. L. Lutz, "Budgets, Bonds, and Ballots", p. 54.

estimates has been in the Bureau of the Budget for 13 or 14 years and he has handled the War Department estimate practically all of that time. He has been in the field, and he knows the War Department set-up, and through long experience he knows what questions to ask in order to elicit information."[54]

The quality of the personnel in the Budget Bureau has probably been above the average for the government service. Through the efforts of these men a relatively satisfactory formulation of the budget and control of expenditure has resulted. An example is provided by the case of a grant-in-aid for old age assistance under the Social Security Board. Prior to the hearing on the item the Budget Bureau had examined a publication put out by the Board's Division of Public Assistance Research. There was included a graph which showed the number of recipients per one thousand population sixty-five years of age and over for each of the states with plans approved by the Social Security Board. Oklahoma with a figure of five hundred and ninety-four was far in the van. The Budget man in charge noted this apparent discrepancy from the average and based a question on it at the hearing. The Social Security Board declared that it had the matter under investigation. Several months later a meeting was held in Washington to determine whether federal aid should be withdrawn from the state. Upon finding that dead men had received grants and that the pension rolls had been padded in other illicit ways, the Board actually did cut off grants to Oklahoma until such time as the state could guarantee that proper administration would be provided. It cannot be asserted with accuracy that the Budget Bureau instigated the investigation. But it certainly pressed the Social Security Board for action and supported it in an endeavor to put a stop to a waste of public money.

The men handling the Budget Bureau hearings have had an arduous task. A good budget examiner must be well versed in the federal budget process, the legislative process, administrative rules and regulations, accounting and fiscal procedure, personnel and purchasing, administrative and financial manage-

[54] 75th Cong., 3rd Sess., House of Representatives, *Hearings before the Subcommittee of the Committee on Appropriations in Charge of the Treasury Department Appropriation Bill for 1939* (Washington: Government Printing Office, 1938), p. 302.

ment within and outside of the federal service, and he must have some grasp of broad questions of policy. Assuming that the federal budget examiners have possessed these qualifications, their task was still an impossible one. The Budget Bureau, it is true, has been severely criticized for the manner in which it has carried out its functions. "The existing staff has become accustomed to a certain routine of duties and has neither the inclination nor the time to do anything beyond this routine."[55] But the factor which made the Bureau's task impossible was the lack of man-power. The question of inclination, therefore, cannot fairly be raised when the reason for basic shortcomings is time alone. The staff simply did not have time to conduct the field studies or investigations and management research which are necessary for an adequate appraisal of the answers given to questions asked at hearings. From September fifteenth to January third the regular estimates were reviewed. From time to time thereafter supplemental estimates had to be considered. But until recently at least, the great bulk of the Bureau's working days (it has been placed as high as three-fourths) were spent in coördinating legislative proposals. Most of the remaining time was usually devoted to attempting to control the budget after passage by Congress and to vacations. In spite of these manifold claims on its man-power, the Budget Bureau managed to sandwich in some intermittent field investigations. Members of the staff took brief field trips in order to obtain first hand knowledge of the activities of their more important units, such as the Social Security Board or the Civilian Conservation Corps. Occasionally special investigators were hired for particular tasks. In 1938, for example, a qualified man was engaged to examine the government hospitals and to develop methods of analyzing their expenditures. More than this it was impossible to do because of the small staff. Up until recently, to illustrate the burden which the Bureau has tried to carry, one man and his assistant handled thirty-seven independent agencies and establishments. It was manifestly impossible for these two men to know so many agencies thoroughly. They simply had to do the best they could, taking the Social Security Board with its complicated economic and social problems on one day and the National Advisory Committee for Aeronautics with its intricate technical questions the next.

[55] A. E. Buck, *Fiscal Management in the National Government*, p. 4.

It is a far cry from old age pensions to wind tunnels, but these men were required to perform such mental acrobatics daily. It is amazing that they were able to exercise any control at all.

The history of the Budget Bureau shows that the inclination to conduct field investigations and to carry on research was present but that the men were lacking. The legal authority for these activities was plain. The Budget and Accounting Act states that:

> The Bureau, when directed by the President, shall make a detailed study of the departments and establishments for the purpose of enabling the President to determine what changes (with a view of securing greater economy and efficiency in the conduct of the public service) should be made in (1) the existing organization, activities, and methods of business of such departments or establishments, (2) the appropriations therefor, (3) the assignment of particular activities to particular services, or (4) the regrouping of services. The results of such study shall be embodied in a report or reports to the President, who may transmit to Congress such report or reports or any part thereof with his recommendations on the matters covered thereby.[56]

Until 1939, the Budget Bureau took no effective steps to meet this responsibility. One reason was that when the Budget Bureau was born a Congressional Committee was studying organization and it was decided to leave that field to it.[57] The Bureau of Efficiency, established in 1916, was also active in the same area. With the abolition of this agency in 1933, however, there was no over-all federal unit engaged in management work. The Budget Bureau, it is true, established a Division of Research and Investigation in 1935 but it was immediately swamped with duties of a nature completely foreign to its title. Voltaire is supposed to have said that the Holy Roman Empire was neither holy, Roman, nor an empire. In like manner the Division of Research and Investigation carried on neither research nor investigation. The Division was not large and its staff was completely occupied with the review of legislative proposals by, and reports on pending legislation from, the executive departments and agencies. There was a realization that: "The first step toward the improvement of the present

[56] Sec. 209.

[57] C. G. Dawes, *The First Year of the Budget of the United States* (New York: Harper and Brothers, 1923), p. 34.

budgetary procedure, therefore, should be the furtherance of the Budget Bureau's investigative work preparatory to the submission of estimates for action by the President."[58] The staff was not large enough, however, to permit this work to be done.

The chief reason for the maintenance of the Budget Bureau staff at a practically constant level over a period during which federal appropriations approximately doubled lies in its peculiar position in the administrative structure. The Bureau has had to assume the role of denying funds to the clamoring departments. In order to convince the supplicants of its sincerity, so the explanation runs, it has had to practice the strictest economy itself. D. W. Bell, then Acting Director of the Bureau of the Budget, realized the speciousness of this philosophy. He presented the case for a larger staff to Congress:

> The increasing volume of work has left little time for these groups to do more than give superficial consideration to the estimates of appropriations submitted by the various organization units, particularly in view of the short space of time in which the Budget must be prepared. The Budget estimates, particularly with respect to the larger organization units, have therefore become little more than ex parte statements by those who ask for funds. A more extensive and comprehensive inquiry with respect to the financial needs of the various organization units is therefore necessary.[59]

In 1938 the Bureau asked for a supplemental estimate which would permit a staff of more than double the forty-five employed at that time. In defense of this statement Mr. Bell stated that

> With complete information at our command we would be able to pass more intelligently upon subsequent requests for funds, not only as to the need for the funds requested but as to the efficiency of the

[58] The Brookings Institution, *Financial Administration of the Federal Government*, Report to the Senate Select Committee to Investigate the Executive Agencies of the Government, Number 5 (Washington: Government Printing Office, 1937), p. 50.

[59] 74th Cong., 1st Sess., House of Representatives, *Hearing before the Subcommittee of the Committee on Appropriations in Charge of Deficiency Appropriations on the Second Deficiency Bill for 1935* (Washington: Government Printing Office, 1935), p. 703.

organization administering funds previously made available for the same purpose.[60]

Mr. Bell pointed out that the abolition of the short sessions of Congress, the restricted staff, and the growth in the number and amounts of appropriations had curtailed investigatory activity. Congress granted the increased funds.

When the new Budget Bureau Director, Harold D. Smith, came into office, he also realized that it was necessary ". . . to remove these hearings from the sphere of a budgetary poker game. . . ." He went on to say that: "Formal hearings are at best very inadequate mechanisms for establishing the basic facts concerning appropriations. . . . Staff studies of intensive and extensive character provide a necessary background for appropriation estimates. . . ."[61] The Estimates Division, with the added staff made possible by larger appropriations, plans to spend considerable time in field work preparatory to the examination of the estimates. The Administrative Management Division will aid through the investigation of specific problems referred to it by the Estimates Division and through general studies of federal organization structure and administrative procedures. Thus not only will a basis be provided for judging the adequacy of answers to questions asked at hearings but the problem of superannuation will also be attacked. Field work should readily reveal whether an agency has been maintained in full bloom in spite of fading functions. The efforts of the Administrative Management Division should also aid in the search for objective criteria. The Budget Bureau will, therefore, be well on the way to overcoming the three greatest shortcomings of its hearings procedure.

THE PROBLEM OF RELATIONSHIPS

The hearings on the estimates, however, cannot hope to be effective in formulating a scientific budget unless the relations between the Budget Bureau and the President are clearly understood. The Bureau derives its powers from the Budget and Accounting Act of 1921 which, in turn, makes it clear that the

[60] 75th Cong., 3rd Sess., House of Representatives, *Hearing before the Subcommittee of the Committee on Appropriations in Charge of Deficiency Appropriations on the Second Deficiency Bill for 1938* (Washington: Government Printing Office, 1938), p. 740.

[61] *The Role of the Bureau of the Budget in Federal Administration.*

Bureau is a staff agency of the President. There is little doubt that the chief executive is free to disregard the Budget Bureau if he so desires. It is accurate to state, in general, that he has not done so.[62] The presidents have realized that the Bureau is an invaluable aid in examining the estimates of appropriation and trying to adapt them to presidential policy. It is quite as accurate, however, to state that certain departments and agencies have at times gone over the head of the Budget Bureau to the President and have obtained special dispensation. One prominent regulatory body, for example, was denied an increased appropriation after a hearing by the Bureau. The unit concerned went directly to the President, after the budget had been formulated, and declared that the money was absolutely necessary. The President gave in. The Budget Bureau was vindicated later on when the agency concerned failed to spend the money which it had gone to so much trouble to obtain. And this is not an isolated case. There have been other such instances. It is clear that too frequent detouring of the Budget Bureau will break down its confidence in itself and the hearings will become relatively less effective. There may be occasions, it is true, when an agency may feel constrained by the exigencies of the moment to carry an appeal to the President as a court of last appeal. Especially is this true of matters of policy. But in any case the appeal should first be submitted to the Budget Bureau in order that it may be given every opportunity to defend its case.

There is no formal procedure for appeals from the action of the Budget Bureau and the President on the estimates. The reason for this is that rehearings, if they became common, would detract from the significance attached to the regular hearings. Evidence might be withheld in the hopes of carrying a subsequent appeal directly to the President. A more lenient treatment might thereby be expected. The Budget Bureau has, therefore, kept the appeals process informal. There are no standard statements to fill out. The department or agency desiring a rehearing makes its arrangements by telephone. The Budget Bureau has also made it clear that only particular items will be so considered, not the total of appropriations for the department or agency. The point is that there is some recourse from the first decision of the Budget Bureau and the President.

[62] Delbert Clark, "The Federal Budget," *New York Times* (December 3, 1939).

The appeals should clear through the Budget Bureau as a matter of procedure and the chief executive should entertain no suggestion for a revision of an estimate unless it comes through the regular channels. If the departments begin to feel that they can obtain more money by going directly to the President, the Budget Bureau will become practically worthless as an agency for shielding the President from excessive demands on his time and energy.

The recent institution of the six presidential administrative assistants by the Reorganization Act of 1939, the so-called "selfless six" with a "passion for anonymity," has raised certain questions concerning the relations of the President, the Bureau of the Budget, and the departments. The Bureau is supposed to have jurisdiction over budgetary matters and, as has been emphasized, the departments and agencies should approach the President through it on such questions. One of the three Presidential assistants appointed to date has, however, been given duties in the sphere of fiscal affairs. This may easily lead to complications unless functions are clearly defined. The possibility of conflicts of jurisdiction is revealed by the attribution, on the part of a reliable newspaper, to the fiscal assistant to the President, of certain functions logically belonging to the Budget Bureau. "As fiscal advisor to the President, Mr. Currie is also his liaison officer with the Federal departments on budgetary matters."[63] This may have been a reportorial error, but it does illustrate the lack of clarity in the existing relationships. There should be a definite understanding that except on matters of broad policy the departments and agencies should first take up their budgetary problems with the Budget Bureau.

STATISTICAL ANALYSIS OF BUDGET BUREAU ACTION

At the beginning of the paper certain broad questions were raised.[64] The subsequent analysis and discussion have given a basis for tentative answers to some of them. There has been, for example, an effort at an objective preview of expenditure requests prior to their submission to Congress. The budget process has served to unearth facts to aid the President in his policy determinations. The effectiveness of the review of de-

[63] *New York Times*, April 25, 1940.
[64] See above, p. 81.

partmental estimates has been hindered by a lack of field investigation and management research, but steps have been taken to remedy this defect. Additional background for formulating answers to these questions, as well as material for judging the extent to which the Budget Bureau has stemmed the tide of expenditure demands, is given by statistical presentation of the actual treatment accorded department estimates by the Presidential staff agency. These statistics also serve to indicate the answer to the question of the attitude of the legislature toward the work of the Budget Bureau.

First a table is offered which shows, for the years 1923 to 1939, how much all departments taken together requested from the Budget Bureau, how much that agency submitted to Congress, and the amounts which Congress actually appropriated. The figures are for the regular annual estimates and appropriations and do not include supplemental and deficiency estimates. That is a distinct problem. There are difficulties encountered in an effort of this nature which give the results the character of a rough indicator rather than a precise instrument. Comparable figures, for example, are difficult to secure not only for a series of years but also for the same year. This is especially true of the record since 1933, the last year for which data were presented through the annual report of the Director of the Bureau of the Budget. For 1934 and 1935, indeed, figures for department submissions are unattainable. The Budget Bureau has excellent figures for the years since 1935. Through the utilization of available sources, however, and after making certain adjustments and corrections, a series of data are obtained which seem to be sufficiently accurate to use as a measuring rod of Budget Bureau effectiveness. In Table 1 the footnotes indicate the sources from which the figures were derived. In the case of the appropriation column it was deemed best to use the records of the Appropriations Committees' clerks instead of the better known *Digest of Appropriations* because the former source made it easier to obtain figures comparable to those in the other columns.

Before essaying an analysis of the table it is necessary to make some general qualifications. The departmental submission figures up to 1933, for example, are the preliminary estimates which were formerly required to be submitted on July fifteenth. They were examined by the President in the light

TABLE 1

REGULAR ANNUAL ESTIMATES AND APPROPRIATIONS, 1923–1939
(in millions of dollars)

Fiscal Year	Departmental Submission[a]	Budget Bureau Estimate[b]	Appropriation Act[c]	Budget Estimate Compared with Department	Appropriation Compared with Budget Estimate
1923	$4,550	$3,225	$3,114	—$1,325	—$ 111
1924	3,386	3,079	3,086	— 307	+ 7
1925	3,337	3,018	2,998	— 319	— 20
1926	3,416	3,092	3,082	— 324	— 10
1927	3,306	3,132[e]	3,182	— 174	+ 50
1928	3,369	3,257	3,260	— 112	+ 3
1929	3,677	3,506	3,531	— 171	+ 25
1930	3,953	3,672	3,708	— 281	+ 36
1931	4,023	3,830	3,827	— 193	— 3
1932	4,239	3,933	3,942	— 306	+ 9
1933	4,169	3,793[f]	3,780[f]	— 376	— 13
1934	[d]	3,776	3,323[g]	[d]	— 453
1935	[d]	3,920	3,983	[d]	+ 63
1936	9,169	9,250	4,322	+ 81	— 4,928[h]
1937	6,377	5,447	5,368	— 930	— 79
1938	7,056	6,391	6,236	— 665	— 155
1939	8,830	7,899	8,639	— 931	+ 740

[a] Through 1933 these are the preliminary estimates called for by the President, a practice since discontinued. They were obtained from the annual reports of the Director of the Bureau of the Budget, except for the 1923 figure which was given by the President in his Address to the Second Semi-annual Meeting of the Business Organization of the Government. Postal expenditures from revenue are excluded. The data in all columns for 1936 on have been secured from the Budget Bureau but the author is responsible for their use here.

[b] Through 1933 from the annual reports of the Budget Director. Postal expenditures from revenue excluded. The 1933–1935 figures are comparable data from the annual budget.

[c] Taken from "Appropriations, Estimates, etc." Prepared for Congress by the House and Senate Appropriation Committee clerks. Postal expenditure from revenue excluded. The postal deficit is included only for the years subsequent to 1928 in order to make the figures comparable to the Budget estimates which include this figure only for those years.

[d] No figure available.

[e] Exclusive of $24 for the adjusted compensation fund later withdrawn by the President.

[f] Reduced by $150 in accordance with Part II of the Legislative Appropriation Act (Economy Act).

[g] Exclusive of $3,300 for the N.I.R.A.

[h] See explanation in text.

of his general policy and total department allocations made. The September fifteenth estimates at that time represented the departmental distribution of the allotted amount. This system was abandoned because it required the departments to formulate their demands long before the period to which they were to apply. The departments were also encouraged to exclude amounts, later submitted as supplementals, in order to

please the President with the moderation of their original demands. The departmental submission figure for 1923 in Table 1 is abnormally large because of certain war agencies and also because the budget system had not actually got under way at that time. For the depression years the figures are complicated by the emergency expenditures. In 1936, for example, relief and the Agricultural Adjustment Administration were not appropriated for by Congress in the regular acts but were provided for in supplementary appropriations. Since regular estimates were included both by the departments and by the Budget Bureau for these two purposes, the abnormal figure of –$4,928 million in the last column is easily accounted for.

In spite of these irregularities, however, it is possible to derive certain general conclusions from Table 1. The Budget Bureau has consistently cut the department estimate as submitted. In fact 1936 is the only year for which an increase is shown. Percentage figures are not necessary to indicate that this restriction has been rather severe at times. It has, however, run from roughly 25 per cent down to 3 per cent of the total as submitted. These figures indicate that the process of budget formulation has resulted in some real control of expenditures. Control, of course, consists of more than the mere reduction of outlays. The real objective of intelligent control is to correlate the amount spent or to be spent with the amount and quality of the work done or to be done, always having in mind the sum of money available for expenditure. Control also involves the problem of the direction of expenditure. All in all it represents an attempt to attain what might be termed an optimum unit cost of administration. The figures presented in Table 1, however, are grounds for a presumption that control has been exercised.

The table would also seem to demonstrate that the Budget Bureau has taken independent action. It has been said that:

> The estimates as they are prepared under existing procedure fail to establish the basis for adequate administrative control through the Budget. Although they are now prepared through a centralized agency chiefly responsible to the President, they still represent to a very great extent (as they did prior to 1921) the estimates of administrative officers, and not of the head of the administration.[65]

[65] The Brookings Institution, *Financial Administration of the Federal Government*, p. 48.

That there is room for considerable improvement in administrative control through the budget cannot be denied. To say, however, that the estimates submitted to Congress are those of the administrative officers and not the President would seem to be contradicted by the foregoing description of the budget process and the accompanying tables. To imply that no improvement has taken place in administrative control since 1921 would seem to be seriously misleading. In assessing the extent of the control exercised it should be remembered that many items in the aggregates used for weighing the effectiveness of Budget Bureau action are not subject to administrative control. Interest on the public debt, for example, is an item which the Bureau obviously cannot touch. The aggregate figures also contain many policy items which are beyond the jurisdiction of the Budget Bureau. In the past nine years total annual expenditures have increased by about four billion dollars. Regular operating expenditures, which are most susceptible to Budget Bureau action, have risen by two hundred and eighty-eight million dollars.[66] Care should be exercised, therefore, before jumping to the conclusion that little or no administrative control has resulted from the review of the estimates.

One of the important factors in assaying the work of the Budget Bureau is the attitude of Congress. An examination of the last column in Table 1 shows that the legislature has, in the aggregate, honored the President's estimates.[67] In only eight of the seventeen years which have elapsed since the institution of the national budget system has Congress seen fit to restore the cuts made by the Budget Bureau. And these restorations have usually been nominal in nature. Of the nine further reductions made by the legislature, those made in 1923 and 1936 are special cases which have been explained explicitly or implicitly in our initial qualifications. The rather large reduction in 1934 cannot be analyzed because of the unavailability of a department figure for that year. The remaining cuts are relatively unimportant and do not seem to alter the validity of the general conclusion that Congress has, by and large, expressed its confidence in the Budget estimates.

It would be possible to state that ". . . the right to recom-

[66] *1939 Budget*, p. x.

[67] These figures bear out the conclusions reached on the basis of an analysis of the first few years of operation of the Bureau. W. F. Willoughby, *The National Budget System*, pp. 140 ff.

mend, to expound and to defend a unified, coördinated financial plan before legislature and public is tantamount to forcing its acceptance. The legislative function in the formulation then becomes mere ratification."[68] This statement, however, ignores the whole development of the executive budget idea which emphasizes good budget procedure as a means of enabling the executive, who represents the people just as much as the legislature does and who is a responsible policy formulator, to present a well thought out program. As a result of this process the legislature and the people are able to see the facts more clearly than in the old days of the legislative budget. The legislature is ill-adapted to work out a detailed financial program. The executive budget permits the lawmakers to function in the role for which they are best fitted. A body of facts accompanied by concrete proposals is presented to them for discussion. Opportunity for intelligent debate is offered. It is not the fault of the budget system if the debate is poor. The acceptance, therefore, of a majority of the President's budgets by Congress cannot be regarded as an indication that the legislature has relinquished its control of the purse. Indeed, this fact may rather be regarded as an appreciation of the assistance which the improved budget procedure has furnished both the President and the Congress.

An attempt to judge the effectiveness of the budget system from a series of data such as that presented in Table 1 cannot rest content with an examination of each year in isolation but must take account of the trend over a series of years. Interesting from this standpoint is a comparison, for the years following 1923, of the prior year appropriation, the present year department submission and the present year budget estimate. The department figure is in every case considerably above the appropriation for the previous year. The budget estimate, except for 1924, 1925, 1933, and 1934, while below the department amount, is nevertheless well above the figure representing the appropriation of the prior year. This might, from one point of view, appear to be proof that control, in the sense of the restriction of expenditure, had not been successful. On the other hand, the figures might be interpreted as indicating that the

[68] Suggested by R. F. Steadman, "The Budget as One of the Most Potent Instruments of Democracy," *Governmental Research and Citizen Control of Government, Proceedings of the 28th Conference, Governmental Research Association*, September 1939 (Detroit: Governmental Research Association, 1940).

Bureau of the Budget has acted as a brake, restraining the impetuous demands of the departments but slowly giving way before the inexorable increase of government functions during the period covered. This analysis also demonstrates that if those critics are right who say that the Budget Bureau's sole aim is to reduce expenditures then the agency has missed its mark. The announced policy of the Bureau, however, shoots at a broader target. The first man to head the agency, General Dawes, stated that

> There is a tendency on the part of many to assume that the Bureau of the Budget is established primarily for the sake of reducing expenditures. . . . This is but one function of the Budget Bureau. It must be as willing to advise an increase in appropriations where the same is clearly in the interest of governmental efficiency and true economy as it is to advise reductions in expenses, which at the present time are so necessary.[69]

In conclusion, it appears that in fact there was a mixture of these elements. The Budget Bureau has always frankly been interested in keeping expenditure down. The burden of proof has been properly on the spender. It has not, however, been averse to increases, where the need was demonstrated, and has been forced to accept the increased outlays which have resulted from the trends of the time.

STATISTICS ON DEPARTMENTAL SUBMISSIONS

An absolutely accurate appraisal of the factors broadly indicated by the data in Table I would require an examination of the departmental estimates and the Budget Bureau and Congressional action thereon item by item. Figures for departmental submissions are not available, however, in such detail. Individual department totals, even, are non-existent, or extremely elusive, for the years prior to 1935. They might be available in each individual department but to obtain them on that basis would be a diplomatic undertaking of the first magnitude. For the last four fiscal years, however, the Budget Bureau has kept records which permit an analysis in some-

[69] Director of the Bureau of the Budget, *Annual Report*, December 5, 1921, as printed in the Alternative Budget for 1923 (Washington: Government Printing Office, 1921) p. xxi.

what more detail than is provided by Table 1. Even though these years are abnormal, due to the depression, the figures will be found useful. Why such data have not before been kept in an easily accessible form is difficult to say. A possible explanation may be that the departmental submissions have been regarded as a matter which should be of concern only to the administration. It may be that there has been a reluctance to wash dirty linen in public due to a feeling that the administrative branch should settle its squabbles on policy and practice internally and then present a united front to Congress and the public. This might be a consideration even though a Congressman is, of course, free to ask what the department submitted to the Budget Bureau. Such reasoning is supported by the fact that no department officer can vouchsafe information as to what his organization requested from the Budget Bureau to Congress unless specifically requested to do so.[70] Another possibility is that the departments do not wish to divulge what happens to their estimates even within the administrative service.

There is, therefore, a conflict of opinion on whether departmental submissions should be made public. The budget contains the financial program of the President as the business manager of the government. As such it should be a synthesis of the thought within the administration. On the other hand, the budget is also a financial report and as such should contain complete information for Congress. This view apparently prevails in many states.[71] Publication of the departmental submissions for the féderal government might result in better information as to the role of the Budget Bureau. On the other hand, the Bureau might be subject to greater political pressure than is now the case. The balance of the evidence at present seems to favor a continuance of the anonymous existence of the Bureau of the Budget as an aid to the President. But this need not deter it from keeping the departmental submissions on file and available for *ex post facto* analysis of the effectiveness of the budget process.

The amounts of the estimates submitted by individual departments to the Bureau of the Budget have never before been

[70] Based on sec. 206, Budget and Accounting Act of 1921.

[71] Of the thirty-one states whose budget systems are analyzed by J. W. Sundelson in *Tax Systems of the World* (New York: Tax Research Foundation, 1938), p. 225, thirteen require publication of departmental submissions.

made public. It should be interesting, therefore, to see whether they corroborate the testimony of the more general statistics of Table 1. The figures are available, as has been indicated, for the past four completed fiscal years. Since there are few discrepancies in the evidence presented by any one of these years as compared to the others, the statistics presented are confined to the year 1937. Table 2 shows the departmental estimates, Budget Bureau estimates and Congressional appropriations for that year and distinguishes between the regular annual estimates and appropriations and those of a supplementary or deficiency nature. Immediate consideration is restricted to the regular annual figures. The discussion will exclude the amount for the legislature since it, by law, cannot be changed by the Budget Bureau. The Department of Agriculture is excluded because of the situation revealed in the footnote to the table.

An examination of the figures reveals that the Budget Bureau reduced the departmental estimate in nine of the eleven remaining categories. The two increases, State and Treasury, were small, on a percentage basis. Since the Budget Bureau total for that year was well below the aggregate of the departmental submissions, the possibility of flexible action within a given policy is revealed. In other words even if the general policy is one of economy, a recognition of the necessity for increased expenditures in certain quarters is not inconsistent with that policy. The scrutiny of Table 2, however, supports the evidence of Table 1 to the effect that the Budget Bureau does take independent action on the estimates.

The generalization, drawn from Table 1, that Congress usually respects the estimates submitted by the Bureau of the Budget is also sustained by Table 2. In 1937 the legislature reduced the budget estimate in seven out of ten cases, excluding the Congressional and Agricultural estimates for reasons already noted and the Independent Offices because of the decision to appropriate for relief in a supplemental estimate. These cuts represented a tacit acceptance of the Budget Bureau's estimate, except in the case of Interior. The three increases voted by Congress still left the appropriation in each case below the department's original request. As far as the regular estimates are concerned, therefore, the data for individual departments support the findings based on the figures for all departments taken together.

TABLE 2

Departmental Estimates and Appropriations—1937
(in thousands of dollars)

Department	Department Regular Estimate	Budget Bureau Regular Estimate	Regular Appropriation	Department Supplemental Estimates	Budget Bureau Supplemental Estimates	Supplemental Appropriations
Legislature	$ 21,874	$ 21,874	$ 23,319	$ 4,338	$ 4,338	$ 112
Independent Offices	1,395,616	1,221,598	732,569[a]	2,586,379[a]	2,480,234[a]	2,889,317[a]
Agriculture	860,224	305,478[b]	779,671	445,377	443,228	3,458
Commerce	38,110	34,264	35,257	9,882	2,777	1,071
Interior	202,856	160,602	128,127	17,597	3,718	9,514
Justice	46,512	43,795	41,224	2,509	828	555
Labor	27,085	25,464	22,885	909	466	422
Navy	588,233	549,591	526,549	29,312	1,566	2,706
Post Office	806,959	783,909	780,585	16,548	15,732	15,769
State	16,022	19,129	17,830	431	407	1,610
Treasury	1,641,764	1,666,783	1,659,836	291,575	284,727	349,480
War	684,097	571,900	574,261	12,675	10,865	7,969
District of Columbia	47,483	43,100	45,514	1,295	677	504
Total	$6,376,835	$5,447,487	$5,367,627	$3,418,827	$3,249,553	$3,282,487

[a] No appropriation for relief was carried in the annual act but $2,214,000 was included in supplementals.
[b] No Agricultural Adjustment Administration estimate included although the department asked for $440,000.
Source: *Records of the Bureau of the Budget.*

A CHALLENGE TO THE BUDGET PLAN

The efficacy of the Budget Bureau's review of the estimates of appropriation cannot be gauged solely from an analysis of the action on the regular departmental proposals. A careful examination of expenditure plans at the start of the year is rather futile if additional funds are supplied during the year without control.

> The budget, when once adopted, should be rigidly adhered to throughout the period to which it applies, unless some extraordinary circumstances should arise making changes necessary. If this is not done, budget making means little and the budget plan is largely a farce.[72]

The budget submitted in January should approximate a complete plan for the immediate future as well as provide a complete report on the recent past. Cognizance must be taken, therefore, of the supplementary and deficiency estimates submitted during the fiscal year which seek to secure funds in addition to those provided via the regular appropriation acts. Technically a deficiency estimate is for a past year or the current year, and implies that the department or agency has surpassed the expenditure limit set for it but that no new factors have arisen justifying that excess. A supplemental estimate, on the other had, is usually designed for expenditure in the year in progress or a subsequent year and is made necessary by new legislation or some unforeseen contingency. Deficiencies, it might be argued logically, should be a good test of Budget Bureau action. Excessive estimates of this type would show either a failure to deter departments from spending prodigally or a failure to provide sufficient funds in the first instance. In either case the Budget Bureau would be open to criticism. But the problem is not so simple. More fundamental than the consideration that deficiencies could be avoided by over-generous regular estimates by the Budget Bureau, is the unfortunate fact that the deficiencies are usually inextricably commingled with supplementals. In most cases there are elements of both in any particular estimate. The two have come to be treated, therefore, as practically synonymous.

[72] A. E. Buck, "The Development of the Budget Idea in the United States," *Annals of the American Academy of Political and Social Science*, vol. CXIII (1924), p. 39.

Deficiencies appear to be a necessary evil. Budget officers cannot predict new legislation. Many items, such as the postal deficit, do not lend themselves to accurate estimation. The regular estimates are, moreover, formulated about a year by the departments and about seven months by the Budget Bureau before the beginning of the fiscal year to which they relate. Some appropriation items, such as that for fighting forest fires, are, finally, treated frankly on a deficiency basis. No effort is made to frame a regular estimate. This does not imply, however, that the evil cannot be kept within reasonable bounds. The Budget and Accounting Act of 1921 recognized both the necessity for supplementals, under certain conditions, and the desirability of keeping them at a minimum:

> The President from time to time may transmit to Congress supplemental or deficiency estimates for such appropriations or expenditures as in his judgment (1) are necessary on account of laws enacted after the transmission of the Budget, or (2) are otherwise in the public interest. He shall accompany such estimates with a statement of the reasons therefor, including the reasons for their omission from the Budget.[73]

Supplemental or deficiency estimates are called upon to go through much the same procedure as the regular estimates. The same forms are used. Justifications are required. Hearings are held. Frequently special information other than that included in the justifications is called for. This is particularly true of requests from the regular agencies and departments. Relief and other emergency appropriations have been matters of policy about which the Bureau has had little to say. Particular care is taken to examine the effect of the supplemental request on the appropriation for the fiscal year to come. If the request is granted, precautions are taken to make clear that it is an extraordinary procedure and that it will not become a regular part of the department's appropriation in future years unless new legislation or unusual circumstances have made it manifest that such must be the case.

The Budget Bureau has sought to restrict the practice of postponing requests for funds until the supplementals. In the circular which it issues as a call for estimates of appropriations it declares: "The estimates of appropriations for the fiscal year

[73] Sec. 203 (a).

1941 must include amounts to meet all requirements for the period July 1, 1940 to June 30, 1941, in order to avoid the transmission to Congress of supplemental estimates."[74] How successful has the Bureau been in enforcing this admonition? An early report of the Director of the Bureau of the Budget claimed that deficiency estimates had been "practically eliminated."[75] The evidence of subsequent years tends to reveal that conclusion to have been a rather hasty one. One expert declares that our showing with respect to deficiencies has been poor in comparison with England.

> . . . it is apparent, nevertheless, that the deficiency estimates have not yet been reduced to a minimum consistent with good financial control. They still threaten to destroy the unity of the budget plan.

While there may be extenuating circumstances "nevertheless it indicates a failure to make adequate estimates at the time the budget is prepared."[76] Another competent student admits that the problem still exists but seems convinced that the Budget Bureau has made strides towards limiting its extent. "The foregoing figures indicate, however, great progress in the reduction of ordinary and avoidable deficiencies."[77] There is, therefore, some conflict of opinion on the matter and it may be advisable to examine figures for years more recent than the late twenties, the period in connection with which both the above observations were made.

The year 1937 was, of course, complicated by the large expenditures for relief and recovery. There is something to be gained, however, by a perusal of the supplemental figures for that year presented in Table 2. Especially is this true when it is recalled that only for the past four years do we have reasonably accurate figures including departmental submissions. A glance at the total supplemental appropriations for 1937 demonstrates that deficiencies and supplementals bulk large in the appropriation picture. They represent, excluding relief because of its special nature, about one-fifth of the regular annual appropriations. Since the proportion about which one

[74] Circular No. 350, July 1, 1939.
[75] July 1, 1923 (Washington: Government Printing Office, 1923), p. 27.
[76] A. E. Buck, *Public Budgeting*, pp. 394-396.
[77] Willoughby, *op. cit.*, p. 118.

student has complained was one-eleventh,[78] it is evident that supplementals are still very much a cause for concern. Much of whatever onus there might be for the Budget Bureau in this situation is removed by the fact that many of these additional items are of the real supplemental type rather than true deficiencies. That is, new legislation and emergency situations of an order calling for large appropriations have been a substantial factor. Many of the appropriations, moreover, have been of a type not subject to administrative control. Claims and refunds offer an illustration of this. After all qualifications are made, however, it must be realized that the supplemental problem remains a serious obstacle to effective control. A true picture of the financial situation for a given year cannot be obtained from the budget as submitted to Congress. The supplemental items must be reckoned into the total. The significance of this is emphasized by the fact that Congress has not supported the Budget Bureau on supplementals in the manner which it has on regular proposals. Table 2 reveals this clearly. The explanation may lie in politics, less faith in the Budget Bureau, or elsewhere, but the fact remains that the supplemental estimates are a real threat to the President's financial plan. The more extensive is the practice of submitting additional estimates, the less comprehensive and effective is the regular budget.

There is nothing that can be done to prevent supplementals legitimately made necessary by new legislation or by emergencies. A semi-legitimate reason for requesting funds after the start of the fiscal year is the difficulty inherent in estimating probable expenditures a year in advance of the beginning of the period to which they are to apply. This means that about two years actually elapse between the time the department begins to think about the estimates for a fiscal year and the day when the last expenditure of that year takes place. The Budget itself is submitted to Congress on the third of January, six months before the start of the fiscal year to which it applies. The suggestion has been made that the Budget be sent to Congress on or about March first.[79] Four months would remain before the beginning of the fiscal year so that time would be available for adequate consideration by the legislature. The

[78] Buck, *op. cit.*, p. 395.
[79] A. E. Buck, *Fiscal Management in the National Government*, p. 7.

Appropriations Committees, moreover, could start work even before the submission of the complete budget by examining estimates already reviewed by the Budget Bureau. A change of dates of this character would move the whole process ahead two months and would tend to improve the estimates of revenue as well as of expenditure. Supplementals arising out of inaccurate estimating should become fewer. A corollary advantage would occur whenever a new President took office. Under the Twentieth Amendment the inauguration is set for the twentieth of January, or about seventeen days after the submission of the budget by the outgoing President. The budget is the financial plan of the Chief Executive yet in this situation he would have had nothing to say about it officially. If the submission date were March first, however, the new President could draft the budget message and introduce his own policy.

CONCLUSION

The manner of formulating the federal budget has been described. The impact of policy and the necessity for having a budget procedure which permits a ready translation of policy into a detailed financial program have been indicated. The great improvement in the budgetary mechanism since 1921 is apparent. There are, however, certain definite shortcomings. The appropriation language seems needlessly complex. Every effort should be bent to prevent the proliferation of legal phraseology in the appropriation acts. The appropriation structure should be simplified. Not only is the language of each appropriation act too involved but there are also too many appropriations. Nor is the budgetary sickness confined to what we have called the head, the estimate proper. The body, the "green sheet" schedules of obligations, suffers from a poor bone structure, inadequate classification of expenditures. The legs are weak and gouty, the justifications fail to present clear and concise substantiating information. The hearings, on the estimates have been fairly effective. The tables of statistics bear this out. The nature of the questions asked at the hearings is further proof. But the hearings, have not been as effective as they would have been had they been backed up by intensive and extensive research and investigation. Finally, in order to present a sufficiently comprehensive plan at the start of each

year, to have budgetary control, and to safeguard the financial program, deficiency estimates must be kept to that minimum which is consonant with a reasonable degree of flexibility. The reorganized Budget Bureau is rapidly becoming equipped to meet these enemies on all fronts. While no budgetary *blitzkrieg* is to be expected, fruitful results should eventuate from persistent efforts at gradual progress.

DEFICIT FINANCE—THE CASE EXAMINED

Benjamin Higgins
Richard A. Musgrave

SUMMARY

THE *decade of the thirties has been an era of deficit finance. Initially a means of providing relief to men and business, the stopgap of deficit spending was developed into an economic policy designed to raise and stabilize the level of income and employment.*

The objective of deficit spending may be stated more or less comprehensively,—it may be the mere provision of relief, or it may aim at the support of a higher level of employment through continued spending or it may be used merely for pump-priming. The reason for deficit spending does not depend on the validity of the stagnation hypothesis, although a condition of economic stagnation will require more extensive and persistent deficit finance than a state of intermittent depression. The slowing down of economic progress accentuates the following: lack of new commodities, lack of capital-absorbing improvements in technique and the loss of the frontier. Cyclical as well as secular aspects of deficit finance need to be considered.

Under favorable conditions a policy of deficit spending provides an effective means of combatting underemployment. But the policy is far from fool-proof. Numerous theoretical and practical difficulties must be overcome. The indirect effect of deficit spending upon business may be detrimental as well as beneficial; implications of debt accumulation must be taken into account; requirements of timing and flexibility raise serious administrative problems; supplementary policies must be undertaken. While these difficulties must be recognized and dealt with, they do not eliminate deficit spending as a useful and essential weapon in our arsenal of public policies. Deficit finance provides no panacea; we still need to develop additional and possibly superior methods of dealing with economic depression: yet, it constitutes an indispensable branch of economic policy in times of underemployment and shrunken income.

THE EDITORS

In the heat of popular discussion of the public spending program undertaken by the Roosevelt administration, there exists very little balanced, dispassionate analysis of the case for public spending in a form which is intelligible to the unsophisticated reader. Outside of scientific journals, literature on this subject tends to be partisan. The chief aim of this essay is to fill the gap by providing a general survey of the argument from an economist's point of view, with a minimum of technical terminology. There is little that we would claim to be strictly original, but we hope to have added to the clarity of the discussion.

THEORETICAL BASES OF PUBLIC SPENDING

Relief

The simplest kind of argument for public spending[1] is that which says, in effect: We have bad times, many men are without jobs. They must be supported by the state. Direct relief is demoralizing, therefore the government must provide work relief. Probably this sort of argument was the major one behind the introduction of the Works Progress Administration. It is not primarily an economic argument. About all that can be said here is that in so far as spending does have a stimulating effect, work relief is preferable to direct relief for the very reason that it is more expensive. *Some* expenditure on capital is unavoidable. Also, the economist might point out the long-run advantages of preserving special skills of workers. The main arena of conflict, however, has not been this sort of argument for spending. Few would deny the necessity for relief of some sort, and few in this country would argue that direct relief is a better system than work relief.

Compensatory spending

The argument for public spending becomes significant when it is presented not merely as a means of meeting an emer-

[1] We shall be concerned only with those arguments for public spending that are based upon unsatisfactory economic conditions, as indicated by unemployment, and a low level of income and production. There are, of course, well-known reasons for government expenditures in the best of times: certain fields of activity lend themselves better to public than to private enterprise; technical conditions of modern living necessitate larger and larger outlays for social welfare—such as for public health and sanitation or traffic regulation. An increase in the standard of living, moreover, may witness an increased relative demand for those goods and services which the public economy supplies.

We wish to express our appreciation of the helpful discussion with members of the Fiscal Policy Seminar and with our colleagues and teachers at Harvard.

gency which will disappear of its own accord, but as a means of eliminating the emergency conditions. It is only at this point that controversy begins. How effective is public spending as a tool for attaining and maintaining a high level of income and employment?

On its least favourable and least complicated level, the compensatory spending doctrine runs something as follows: We are subject to periodic fluctuations in national income and employment. It is highly desirable to introduce a greater degree of stability into the economic system, to maintain "full employment."[2] It behooves the government, therefore, to provide means of absorbing men into public works whenever they are released by private enterprise because of slack business conditions; and conversely, to release men from public works whenever private enterprise recovers. In this manner violent fluctuations in income and employment can be avoided, even though real income may fall somewhat in periods when the proportion of men engaged in public works is high. It is not expected that the public works program will in itself provide the stimulus for recovery; no more is hoped than that a cumulative decline will be prevented.[3] Thus, this argument is only slightly more sophisticated than the "relief" argument.

Other advocates of public spending as a means of raising income to the "full-employment" level base their argument on the theory of the "multiplier." According to this theory, national income will rise by more than the amount of the original expenditure. The reason is simply that a certain proportion of the income created by government expenditure will be re-spent, so that secondary increases in income are created; and the same portion of these secondary increases in income are again re-spent, and so on.

In Keynes' mathematical formulation,[4] the "multiplier" is

[2] "Full employment" is admittedly a vague term. It clearly does not mean that every adult has a job. Allowance is always made for "transitional" unemployment due to shifts from one industry to another, and for "unemployables." It may also allow for those who can only be employed in periods of over expansion. As we use the term, "full employment" means the highest level of employment that is compatible with stability or which is possible without resulting in inflation.

[3] In technical terms, this case could be described as one in which the "multiplier" is not regarded as being greater than one, and where "relation" or "acceleration" effects are ignored. These terms are explained below.

[4] If C is consumption and Y is income, then the "multiplier," "k," is equal to $\dfrac{1}{1-\dfrac{\Delta C}{\Delta Y}}$. If, for example, the marginal propensity to consume is equal to 9/10,

regarded as operating instantaneously; everyone is set to make all reactions to the government expenditure as soon as it occurs. In this simplified version, the rate of re-spending for consumption purposes, or "marginal propensity to consume," may be assumed to be constant. It is recognized that in reality the "marginal propensity to consume" is likely to vary over the cycle, and during the process of expansion which results from government spending.

In most of the discussion of the multiplier, the initial spending that gives rise to an initial increase in income takes the form of investment, either private or public. Logically the multiplier idea can be applied to an initial increase in income from any source whatsoever.[5] The government expenditure need not take the form of "investment" in the sense that the spending will result in some kind of capital goods. A straightforward dole would, so far as the pure multiplier theory is concerned, do equally well. It is only necessary that the government expenditure be "income-creating."[6] To decide whether public spending is "income-creating" or not, the source of revenue must also be considered. It is not necessary to the multiplier theory that the expenditure be financed by borrowing. If money is taken from the rich by taxation,—money which would otherwise have lain idle in cash balances,—and paid out to unemployed who spend it, the "multiplier" operates from that point forward. Yet there is always the danger, when revenue is raised by taxation, that spending will be reduced in some other sector of the economy. If, for example, the spending were financed by payroll taxes that were paid directly or indirectly by laborers, it is highly doubtful whether the revenue-expenditure process would be "income-creating."

A somewhat similar basis for public spending is the "accelera-

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so that 9/10 of any increase in income is re-spent, then the total income created by \$100 of government spending is \$100+\$90+\$81+. . . , a series adding up to \$1000 at infinity, and the multiplier is 10.

[5] The statistical measure of income-creating expenditures is a monetary one. An addition to money income is no objective in itself. If the addition to money income remains unspent or merely raises prices, not much is gained. However, under conditions of unemployment the addition to money income is expected to result in an addition to real income. It is the latter with which we are concerned.

[6] The basic idea of the multiplier could, therefore, be more accurately expressed as $\Delta Y_{t=s}\,{}^{\infty}_{\circ} = K \cdot \Delta Y_{t=o}$, where the subscripts refer to time periods. That is, the increase in income when an unlimited time has elapsed in which the multiplier works itself out, is some multiple of the increase in income in the original time-period. Here "k" is defined as above.

tion principle" or the "relation." Here too, the ultimate rise in income is a multiple of the original expenditure. Instead of concentrating on re-spending for consumption, however, the "acceleration principle" and "relation" draw attention to the increase in *investment* which follows an increase in consumption. In the acceleration principle proper, the increase in demand for consumption goods causes a more than proportionate increase in demand for capital goods, (plant and equipment) used to produce them; to meet the increased demand for the final product, plant and equipment must not only be replaced as it wears out, but must be expanded. The "relation" is a somewhat broader concept, including in the increase in investment any new demand for plant and equipment which is used to produce commodities where no increase in demand has as yet been perceived, but where one is expected because of increased consumption in other lines.[7]

Government spending may also lead to increased or decreased private investment which is not based on any change in consumption, but upon an accompanying revision of expectations with respect to the general economic situation. It seems convenient to exclude such psychological reactions from the "relation" and to give the resulting changes in investment a separate label. We shall call them "induced investment." Unlike the multiplier and the relation, induced investment may be negative.

Similarly, government spending may result in a rise in consumption greater than the initial increase in income, through induced dishoarding or extension of consumers' credit. One could say that in this case the "marginal propensity to consume" is greater than unity, but what really happens is not that consumption increases more than income but that income is increased in the initial phase not only by the direct government spending but by the accompanying increase in consumption through dishoarding or consumers' credit. The *multiplicand* in this case includes other items besides government spending. It seems better, therefore, to distinguish between the proportion of government-created income that is re-spent and the accompanying increase in income which is only indirectly due to gov-

[7] If one wanted a symbolic expression of the "relation," it would be $\triangle I = R \cdot \triangle c$ where R stands for the relation coefficient. It should be noted that in a pure "relation" analysis, the "multiplier" is assumed to be one. Cf. note 4 above.

ernment spending. The latter we shall call "induced consumption." Induced consumption may, of course, be negative.

A comprehensive theory of public spending must include induced investment and consumption as well as the combined effects of the multiplier and the relation. Adopting a term of Professor Hansen's, we shall call such an all-inclusive theory "leverage analysis." There is no logical necessity for the "leverage coefficient" to be greater than unity. The multiplier cannot be less than unity nor the relation less than zero, but induced investment and consumption may be negative.[8] "Leverage analysis" is enormously complicated. Even when induced investment and consumption are ignored and the multiplier and relation coefficients assumed to be constant, a variety of possible reactions to government spending may result, depending upon the relative magnitude of the coefficients.[9]

Pump-priming

The chief difference between the pump-priming theory and the concept of "compensatory spending" is that the former does not involve continual spending, while the latter does.[10] According to the pump-priming theory, a temporary and relatively small spending program will suffice to raise national income to a high level more or less permanently. The boom may come to an end for some reason or another, but there is nothing inherent in the spending itself which necessarily leads to a relapse if spending stops. Once under way, the recovery has the characteristics of a spontaneous upswing, and is no better and no worse than that. "Multiplier" and "relation" effects are of course included in the pump-priming principle but so are "induced" investment and consumption. After the initial expenditure the leverage operates independently of the spending injection. All that is necessary to start the upswing is to provide

[8] We could write $\Delta Y_{t=s}\,{}^{\infty}_{0} = L \cdot \Delta Y_{t=0}$ where "L" is the leverage coefficient, the other symbols defined as above. Enlarging on an equation of Samuelson's, we could write $Y_n = K \cdot S_{o \ldots n} + I_n + R_n (C_n - C_{n-1}) + C_n$. The subscripts stand for time periods, "S" for amount spent by the government, "I" induced investment, "C" induced consumption. The multiplier "k" is not the Keynesian one. Since "I" and "C" may fall with an increase in "S", "Y" may also fall.

[9] For an exposition of the various types of reaction possible, cf. P. Samuelson, "Interactions between the Acceleration Principle and the Multiplier," *Journal of Political Economy*, Dec. 1939.

[10] This statement applies less obviously to the "relation" than to the "multiplier." The question of whether or not a recovery based upon the "relation" will lead inevitably to a downturn, with or without continued spending, is dealt with below in the section on "maintaining equilibrium."

the initial stimulus, and from there on recovery proceeds mainly through induced consumption and investment. Induced investment has its own "leakages," which will be discussed below under the heading "Public Spending and Business Reaction."

Analytical formulation of the pump-priming principle might run as follows: After a period of deflation, in which excess investment or malinvestment of the previous boom has been liquidated, inventories reduced to a low level, durable consumers' goods and some capital goods have depreciated to the point where replacement will soon be necessary, costs have gradually been reduced until they are not inordinately high relative to prices, banks have piled up excess reserves, the stock market has become inactive but relatively stable, etc. etc., the economic system is bumping along at the bottom of the trough. The stage is set for recovery, but business expectations are still gloomy and general uncertainty still prevails. All that is necessary is some definite indication that the upturn has been reached for the latent recovery to spring into being. This indication will result from a small and temporary income-creating expenditure program of the government. Increased purchasing power will show itself in certain lines of production, leading to increased output and employment in those lines. Once started, the recovery will continue of its own momentum. Re-employment in some lines causes increased buying in others, leading to further investment and employment there, and so forth.

Additional Problems Arising out of "Secular Stagnation"

As the pump-priming approach to the public spending doctrine is most optimistic, so the "secular stagnation" approach is most pessimistic. Here the problem is not considered merely one of raising income to the *cyclical* peak—or as near that peak as is compatible with stability. Even that level of income would be unsatisfactory. For, according to this point of view, the era of increasing private investment is over—apart from temporary stimuli such as war or some quite unforeseen developments. Population no longer grows at its previous rate, and the day of a stationary or even a declining population is in sight. There is, accordingly, little incentive for investment in housing, public utilities, transportation, etc.—precisely those fields which in the past proved capable of absorbing large amounts of capital. The frontier, safety-valve of previous de-

pressions, has disappeared. There are no longer any new, relatively accessible natural resources to exploit. No new inventions are coming along capable of absorbing more capital than is invested in existing plant and equipment. On top of this is the general aura of uncertainty over the whole field of possible investment, which is a result of the violent economic and political upheavals of the past decade. Under such circumstances, few are inclined to make new investments. Yet they do not spend all their incomes, either. We are cursed with a continual stream of new savings for which there is no profitable outlet. The only solution is for the government to absorb these savings by offering a liquid and secure form of investment—government securities—and to spend them on useful public works projects. The government must take up the slack in current investment, as a permanent part of its function. If people continue to spend less than their entire incomes, the government may find it necessary to extend its operations over a wider and wider field of enterprise or to redistribute income towards equality.[11]

It is not a matter of indifference whether we *have stagnated* or *are stagnating*. The former situation would mean only that the amount of spending needed to reach a "full employment" level of income would be greater than if the problem were purely cyclical. The latter situation, involving a trend of widening discrepancies between accumulation of loanable funds and opportunities for investment, calls for an ever *increasing* volume of public expenditures, even to maintain income on its present level. This less favorable condition is the one that most supporters of the "secular stagnation" doctrine seem to have in mind.

It should be clear from the above analysis that the argument in favor of public spending by no means stands or falls with the doctrine of "secular stagnation." Given an unsatisfactory level of income and employment, a case can be established for attempting to raise the level by a governmental spending program. However, the results we can expect from spending, and

[11] The Keynesian argument is not markedly different from this one. What differences there are are largely terminological. The "marginal efficiency of capital" is low, and accordingly investment and income is at a low ebb. The "average propensity to consume" is too low for there to be sufficient stimulus from the consumption side to raise the level of national income. There is a limit below which interest rates cannot be reduced in an endeavour to encourage investment. Hence investment outlets must be provided by the government, or the "propensity to consume" must be increased by redistribution of income.

the nature of the projects that should be chosen, are not independent of the kind of situation we think we are trying to cure. It is worth while, therefore, to examine this situation before proceeding further.

The Economic Problem of the 1930's

The currently popular thesis that the basic cause of continuing unemployment is the inadequacy of investment outlets relative to the volume of current savings raises an analytical and an empirical issue. The analytical issue is, first, "How does over-saving produce unemployment?" and second, "How does economic maturity yield over-saving?" The empirical issue is, "Does economic maturity constitute the chief explanation of the situation in the thirties?"

(1) At the outset, we grant the theoretical argument. Over-saving can lead to unemployment, economic maturity *can* lead to over-saving. A "model" theory of over-savings might run as follows:

In an "equilibrating" society,[12] operating at a high level of activity and with reasonably optimistic profit expectations, a small increase in current savings tends to be allocated to various types of capital goods industries through its effect on the structure of interest rates. A large and sudden increase in savings, however, may produce losses in consumers' goods industries, a downward revision of profit-expectation, and a decrease rather than an increase in investment. Income and employment accordingly fall; the fall in the interest rate which is compatible with the ruling demand for cash balances (liquidity-preference) may not be sufficient to lead to an absorption of current savings. This result is all the more likely if the initial fall in demand for final products is expected to continue, and prices are expected to fall; for then the demand for investment funds will fall off, while the demand for cash balances (liquidity-preference) will rise. Thus a cumulative decline in employment, output, and income, can continue until the level of income is so low that savings no longer exceed investment.[13] This new "equilibrium" may be one with a considerably lower volume

[12] That is, a society in which there are no institutional barriers to adjustment.

[13] "Hoarding", in the sense of a falling velocity of circulation of money, comes to an end when income has fallen to the point where all current savings are absorbed into investment.

of employment than the original one. Nor would flexibility in the general level of wages necessarily prevent such a result, since decline in general wages has as an impact effect a further reduction in demand for goods. The same process can start with a given volume of savings and a sudden reduction in demand for loan funds, or with a given volume of both savings and investment and a sudden increase in demand for cash balances (liquidity).

The least satisfactory element in this sort of over-savings theory is the explanation in terms of "liquidity-preference" of the failure of adjustment to the increased supply of savings through a fall in the loan-rate of interest. It is admitted that when incomes and prices fall due to deflation, the demand for cash balances for ordinary expenditures (from the "transactions motive") will decline. The failure of interest to fall is explained in terms of the "speculative motive." The argument has two aspects. First, it is pointed out, as interest rates fall, the "opportunity cost" of holding cash falls, so that people hold a larger proportion of their total assets in cash. However, this factor may be partly offset by the *increased* opportunity costs of holding cash in terms of consumption as incomes and prices fall. Moreover, it is only the holdings of *some* assets, such as Treasury bills, that decline as a result of reduction of those interest rates which the monetary authority controls directly. The yields on other and especially new investments are likely to be relatively little affected, and the supply of loan funds for new investment will not decline significantly. Second, it is maintained, if interest rates fall below the normal rate, people will expect them to rise again, and accordingly hold cash instead of other assets. If by "expected rise in interest" is meant a fall in price of assets with constant or falling returns, such that yield increases, the argument provides an explanation for a continued fall in price of assets in a down-swing. But once the price of assets has fallen enough to raise the yield to the normal rate, why shouldn't investment take place? If the "expected rise in interest" takes the form of rising returns with constant prices or less than proportionate rises in prices of assets, people would postpone investment only if buying now meant foregoing the higher yield in the future; and there seem to be few cases in reality where such is the case. It may be that people expect a rise in yield of some assets but

don't know which, and so postpone buying; but this is a different argument. It would seem that other factors than holding cash on the "speculative motive" must be introduced into the explanation of persistent over-savings.

(2) How is "secular stagnation" related to the over-savings argument? First, the failure of important new *commodities* to appear, or to continue appearing, may affect the savings-investment relationship unfavorably from both sides. The development of new commodities may bring about prosperity either by stimulating increased investment and thus raising incomes enough to justify the investment, or by inducing people to spend a larger proportion of their incomes and so give an incentive to investment. When the plant and equipment needed to produce the new commodities are in operation, the level of income and employment must fall unless more new commodities appear on the scene. Failure of new commodities to appear may explain either a drop in income and employment, or, with a given volume of savings, the continuing low level of income and employment. It cannot explain why savings do not diminish in accordance with the fall in income, and continue to exceed investment despite the low level of income.

Secondly, current improvements in the technique of producing established commodities *may*, but need not, give rise to increased investment. Considering the problem from the long run point of view, much will depend upon whether the improvements will increase or decrease the capital-intensity of production. A capital-saving improvement will in time result in declining investment outlets, unless its cost-reducing effects are such as to offset or outweigh the reduction in capital used per unit of output by an increased volume of production. In the short run even a capital saving improvement may give rise to a temporary increase in investment if the improvement is introduced at a rate in excess of that of the depreciation of the old equipment. What this rate of introduction will be depends upon the relative magnitudes of cost-reduction with the new technique, as against the prime cost of producing with the old technique, as well as upon the state of competition that prevails. A declining rate of current improvements or a qualitative change of improvements towards a lower capital-intensity provide further explanations why investment outlets may shrink. The argument does not explain the persistence of over-saving.

From a theoretical point of view, the disappearance of the frontier plays much the same role as lack of new commodities and of capital-absorbing improvements in technique. The frontier provided the means of producing new commodities, or of producing established commodities at lower costs through the use of free land or discovery of new resources. The opening up of a frontier may support a boom; its disappearance may cause a recession. Its presence provided a safety-valve for depression which is lacking today. However, as a means of absorbing capital, a frontier does not have a clear-cut advantage over highly-developed areas. For against the capacity of a new country (within or without our own national borders) to absorb *capital* exports, must be balanced the capacity of a highly developed country to absorb commodity *exports*, and so provide the basis for investment in export industries.

The bearing of population growth upon the saving-investment problem is a complex matter. Inasmuch as growing population is tantamount to growing consumption, the "acceleration principle" argument suggests that a mere decline in the rate of population growth will lead to a fall in investment. But rising (or falling) consumption ceases to be a necessary corrollary to rising (or falling) population growth, once attention is directed towards the movement of per capita rather than aggregate figures. Per capita consumption may rise while the population growth tapers off if simultaneously there occurs an adjustment of per capita savings to per capita investments.

There is good reason for correlating population growth with increased consumption of certain kinds of commodities, such as housing, transportation, and public utilities. These are commodities whose production has absorbed considerable capital in the past; and they are commodities whose output is not likely to rise very much as a result of a future rise in "standard of living" alone. The reason is that they are commodities produced by highly durable plant and equipment, and if produced at capacity have a very inelastic supply in the short run. Accordingly, when a tendency develops for people to move into larger houses, to replace gas with electricity, to use airplanes instead of railways, due to a rise in the standard of living, the demand for small houses, gas, and railway transportation takes a sharp drop *unless* the population is increasing at the same time. Because of the inelastic supply, the rents of small houses,

the rates on gas, the railway fares, tend to drop to the level where the existing supply is once more demanded, and the intention of people to move into larger houses, etc., is reduced accordingly. If the population were increasing, there would be a demand for *both* large and small houses, even with a slight drop in rents of the latter. Thus with a stable population, the rise in the standard of living shows up primarily as an increased demand for services, conventional "comforts" such as automobiles, radios, telephones, refrigerators. The production of these commodities is apt to absorb less capital than housing, public utilities, and transport. A rise in standard of living, alone, can provide less opportunity for investment than a rise in both standard of living and size of population.

There seems to be no obvious relationship between a declining population growth in itself and the volume of per capita savings. If people have fewer children, they may find it less necessary to save; if they have more children, they may be unable to save. A declining population growth means a higher proportion of adults, a higher proportion of old people. Such a trend means shifts in demand, but no clear-cut change in total spending. Old people may be more or less dependent than children. For a while, there will be a larger number of people of marriageable age, which will increase the demand for housing; but smaller families require less housing space. Adults demand more services, fewer schools.

On the investment side, the declining population growth has one other important effect. Where the population is not increasing, over-investment or mal-investment in durable equipment which produces services, such as apartment houses or power plants, is more serious. There is no chance of a subsequent rise in population making the investment turn out favorably. Thus the risk of investment in such fields is increased, and with other conditions unchanged the volume of investment will tend to be reduced.[14]

[14] In discussion of the population problem, it is well to distinguish between the level of population and the trend. It is foolish to deny that with given resources, a given volume of savings and investment, a given technique, the level of population may be too high, in the sense that per capita real income could be raised by a reduction in the population. Thus the declining population growth in this country is not necessarily a cause for lamentation. If the level of investment can be raised, or the propensity to consume raised, without a continued rise in population, we may be better off than if population did continue to increase. A larger population, as distinct from an increasing population, is truly desirable only when there are resources with which it can be economically combined. With fixed technique and fixed supplies of other factors of production, the Malthusian argument still holds.

It may be that the psychological characteristics of business men are also changing, that the spirit of enterprise is declining in the sense that men are less willing to invest even with a *given* risk and lack of liquidity. The subject is too elusive to permit the determination of any secular trend, although there are certain factors which point in this direction. The desire to accumulate capital for one's children, to see the family grow in wealth and importance, has been a powerful incentive in the past. It is tending to disappear, *pari passu* with the decline in population itself. The "mechanization of progress," whereby improvements in commodities are developed day by day by salaried research workers in industrial laboratories, and are introduced only when it is necessary to keep up with competitors, and whereby improvements in technique are introduced only as existing plant wears out, may stifle the enterprising spirit. The larger proportion of old people in the population may inculcate a general attitude of conservatism, the restricted opportunities for youth may shift the emphasis from adventure to security. There seems to be a trend towards increasing governmental control, a growing hostility to large fortunes, which may provoke a decline of the capitalist spirit. But these are mere speculations.

(3) Turning now to the empirical problem of the significance of the "secular stagnation" argument for the period of the thirties, we find that the general characteristics of "economic maturity" seem to have been present.[15] Three secular factors stand our clearly, providing some explanation of the low demand for investment funds: The declining rate of population growth, the disappearance of the frontier and the diminishing demand for new capital equipment due to improvements in technique.

The rate of population growth fell from 14.8 per cent in the twenties to 7.2 per cent in the thirties; the average annual increase in population declined from 1,880,000 persons for 1920–1924 to about 900,000 persons for 1930–1934.[16] Thus, in absolute figures, the population is still growing, and will continue

[15] The definition of saving and investment and their statistical measurement provides great difficulty. Even under conditions where unemployment is due to "oversaving," no piling up of hoards of unspent income need be present. The "excess" of saving may mean simply that the prevailing level of income is lower than it would be if the volume of savings were lower.

[16] Figures include and are partly explained by the decline in net immigration.

to grow until 1980 or so, if the present trend continues. This population trend is sufficiently longstanding that it can be projected into the near future with reasonable assurance. In explanation of the exceedingly low level of residential construction during the thirties (an annual average of $800 millions from 1930–1935 as against an average of $4.3 billions from 1925–1930) the role of the population trend is difficult to estimate. Construction activity itself moves in cycles and it was not surprising that the housing boom of the twenties should be followed by a decline in the thirties. Accordingly, residential construction can be anticipated to recover in spite of the population trend. Demand for housing and other durable consumers' goods resulting from the upward shift in the age pyramid inherent in a declining rate of population growth, moreover, may offset the effect of declining number for some time. Whatever the effects of the population trend in the thirties may have been, its economic significance for future years can certainly not be denied.

There is a sub-trend within the population that is of further interest. The percentage of white collar workers in the population has increased from 35 per cent to 44 per cent within the last sixty years. In general, white collar workers have more highly developed tastes, feel the necessity to "keep up with the Joneses" more keenly, than manual laborers. Thus this trend may lead to a growing "propensity to consume" which would alleviate the tendency to over-saving. On the other hand, this effect might be weakened by additional savings for purposes of providing better education, etc.

The American frontier in a geographic sense has indeed disappeared and it stands to reason that the more frontiers are exploited, the less there are to exploit. There is, of course, plenty of unoccupied land; unless this land yields mineral wealth not yet discovered, there seems to be little that can be done with it. On the contrary, the margin of cultivation is already over-extended. When applied to the world in general, the argument is less clear-cut. The great masses of people in China, Japan and India provide the basis for substantial foreign investment. Africa, South and Central America may still hold concealed natural resources which could be exploited by foreign capital. Industrial development of backward countries, moreover, will increase rather than diminish the chances of exports.

It should be added that so long as labor supply and natural resources are increased proportionately with capital supply, the marginal return of capital need not fall; but if labor supply (population) and natural resources (opening of frontier) fails to keep pace with capital accumulation, marginal returns will fall and investment will be discouraged.

In so far as the need of increased capital equipment results from improvements in technique (rather than from the introduction of new commodities) a secular tendency may well exist. The more capitalistic a structure of production becomes, the less need is there for it to become more so. Current improvements are largely of a "capital saving" nature. There is a trend towards the use of large-capacity equipment, with smaller capital outlay per unit of capacity. Improvements in instruments for repair work, the increased durability of equipment, standardization of parts, reduction of friction by better bearings and lubricants have prolonged the life of machines and greatly reduced the volume of annual replacement. More efficient arrangement of factory layout has increased the capacity of existing plants. Research done in industrial laboratories is in large measure devoted to problems of reducing capital costs per unit output. The declining rate of industrial growth, particularly in the basic industries, is seen with especial clarity in the older industrial districts, such as the Pittsburgh area.

The introduction of new commodities, inducing a rise in the propensity to consume and so creating new investment outlets, was similarly slow in the thirties. This is not to say that there have been no engineering advances; but the advances have been mainly of the sort which merely improve existing commodities, or reduce their cost of production. Great strides have been made in the use of resins and plastics; now textiles like "nylon" have appeared; neon is widely used for signs; diesel engines are being adopted; stream-lined trains improve service. But such inventions provide no basis for greatly increased spending. Low-cost housing, air-conditioning, television, aviation—these have been slow in developing and, excepting the latter, promise no outlets for large increases in consumption or investment in the near future.

The extent to which this lack of new commodities is to be considered a secular condition is rather doubtful. It may be that the more new commodities that are introduced, the harder

it is to invent new ones; but there is much less secure basis for attributing a secular trend to inventions of this sort then there is for the other factors. Experience suggests that whatever the movement in invention, the introduction of new commodities (innovations) is periodic. Replacement of durable consumers' goods is also periodic. It is on such grounds that much of the difference between the twenties and the thirties can be explained. The secular trends were already present in the twenties, but they were offset and hidden by increased consumption demand, partly for new commodities like automobiles, partly for replacement like housing and utilities.[17] In the thirties, no such demand appeared but it may develop at any time.

The similarity of the period following 1918 to the period following 1873 and more especially to the period following 1815, gives further support to the thesis that we are now in the trough of a "long wave." Quite apart from secular trends, there appear to be long periods of relatively high activity and income, made possible by the growth of some dominating industries, followed by long periods of relative inactivity in which no new industries of the same importance appear. An upswing of this sort occurred from the middle eighteenth century to the end of the Napoleonic Wars. It was followed by over thirty years of low prices, unemployment, shrinking foreign trade, deep underlying agricultural depression, predictions of "stagnation," heated controversy with respect to remedial measures, sporadic and incomplete recoveries over short periods. Much the same was true of the seventies. We seem to be undergoing a similar experience now.

Next, there are some institutional factors which help to explain persistent over-savings and failure of interest rates to fall. It is clear, first of all, that there are limits below which certain kinds of interest rates, such as bank loan rates and mortgage rates cannot fall if the institutions engaged in making these loans are to cover costs of operation.

In the second place, there is a certain stream of savings which is more or less independent of both interest and income, savings for specific purposes such as support of old age, provision for emergencies, etc. Of prime importance in this category of saving is insurance, which has grown enormously in recent years,

[17] Also, "acceleration principle" effects of a declining rate of expansion may show up suddenly as an absolute decline in investment in some stages and fields.

and might even be considered a secular stagnation factor. Income of life insurance companies amounted to .1 per cent of national income in 1880, 1.6 per cent in 1890, 2.8 per cent in 1915, 4.1 per cent in 1925, 11.6 per cent in 1932. Other types of insurance, public and private, show a similar growth.[18] Payment of insurance premiums is the last thing an individual abandons when his income shrinks. Yet the insurance companies are bound to conservative investment programs, holding mainly bonds, and in recent years a growing proportion of cash. Benefits paid rarely amount to premiums collected.

A third institutional factor is the growing importance of corporate savings, another trend which might be called secular. The prevalence of high profits has enabled corporations to accumulate funds of sufficient magnitude to finance a large portion of their expansion from their own incomes, without going into the capital market at all. In the years 1935–1937, 92 per cent of corporate expansion was self-financed. Much of the surplus was built up during prosperity, but bound by custom, corporate saving continued during depression wherever earnings permitted. Surpluses and reserves were accumulated for their own sake, to provide for possible future expansion, to meet contingencies, to maintain dividends if still worse condition arose. By law, by charter, or by policy, investment of corporate surpluses in risky fields is often forbidden, a growing

[18] The place of the Federal Old Age Pension scheme in this picture is doubtful, due to the 1939 changes in the Social Security Act. Previously, under the self-sustaining reserve plan, there was little doubt that for many years to come the effects of the plan would be deflationary. Revenues collected in the form of payroll taxes are apt to be drawn from income otherwise spent on consumption. Payroll tax revenues, in so far as they later exceeded benefit payments, were to be spent for purposes of debt redemption or for objectives otherwise financed by additional borrowing. In the former case it is likely that a large part of the outlays would not have found their way into the flow of consumers' expenditures; in the latter case, no generalization can be made. But even if the payroll tax revenue is assumed to be spent for relief purposes, the total process might be deflationary if in absence of the payroll tax the same expenditures would have been financed otherwise.

The 1939 amendment to the Social Security Act shifts the old age pension plan towards a "pay-as-you-go" basis. Reserve accumulation will now proceed much more slowly and only for a short time. Most of the payroll tax revenue will be respent immediately for benefit payments, so that no definite effect upon the flow of savings and consumption outlays can be determined. The possibility, furthermore, that the scheme will lose its self-sustaining basis and become dependent upon general revenue sources for subsidies, may render its effects saving-reducing. Whether this advantage was worth the price of overhauling a carefully planned scheme as contained in the 1935 Act, is an open question. The political pressure of the Townsendite and similar groups may well lead to a further extension of benefits and the merging of the old age pensions with some "redistribution" scheme.

proportion of corporate reserves is held in the form of government bonds or cash balances. Habits with respect to depreciation allowances contribute to this stream of corporate saving. Replacement allowances are not substantially reduced during depression, partly due to rigid adherence to conventional schemes of depreciation, such as straight-line depreciation, and partly because the American tax system puts a premium on high depreciation charges. In 1933, expenditures on new durable goods by non-financial corporations fell short of their replacement allowances by over two billion dollars.

Mention must also be made of the impact of the American tax system during the thirties. A federal system of business taxation with insufficient allowance for losses and volatility of incomes, exceedingly high rates in the top brackets of the personal income tax and an unfortunate tradition of tax-exempt government securities, combined to penalize investment in venture capital. New taxes were experimented with. Mounting rates of local property taxes exerted depressing effects upon real estate values and might go a good way in explaining the low ebb of construction. In all, tax policy was anything but coördinated with the objectives of public spending.

Finally, there are certain special features of the period of the thirties, complete economic explanation of which is lacking. First, there is the exceptional severity of the 1929 crash and the international monetary crisis of 1931–1933. This catastrophic collapse upset the expectations of business men and investors so completely that confidence in the very system was undermined. Only clear-cut evidence of a "return to normality" was likely to restore this confidence. Such evidence has not been forthcoming. On the contrary, subsequent events served to frighten entrepreneurs still more. Governments at home and abroad were overthrown and the new governments behaved in an unprecedented manner and with breathtaking rapidity, without bothering to consult business men. Policies which were designed to improve business conditions were carried through without sufficient warning, without complete explanation and in a general atmosphere so hostile to big business that they failed to have the desired effects. The growing strength of labor groups was an additional cause for worry and seemed somehow to be an offshoot of the new economic policies.

Wars broke out all over the world, there was talk of involvement of this country. Small wonder that business men and capitalists continued to be throughly frightened.

It seems to us impossible to over-emphasize this general and pervasive uncertainty. Here in itself is an explanation of persistent over-saving. Under conditions of this sort, lenders will part with cash only for high interest rates, borrowers will make commitments only for very low interest rates. The increased nervousness about the future at once increases the propensity to save for emergencies and whatever fall in interest rate may occur is insufficient to induce people to borrow and invest.

From the point of view of public policy, this estimate of the existing situation has certain implications. First, to the extent that there is an underlying secular problem, some policy of a relatively permanent nature must be undertaken. In addition, policies of long duration—say ten years—must be considered to deal with the "long waves." On the other hand, since cyclical upswings will reoccur, some policies must be of the sort that can be put into action and out again with maximum speed. In undertaking these policies, particular attention must be paid to getting the understanding and support of business men, in order to strengthen confidence and not to disturb it any further. At the same time, efforts to encourage investment and to increase the "propensity to consume" (decrease the volume of savings) are called for. The question is, then, to what extent public spending is designed to meet this complex situation.

THEORETICAL PROBLEMS OF PUBLIC SPENDING

We have already indicated that the necessity of providing relief for the unemployed in times of depression, and the advantages of work relief over direct relief, are beyond dispute.[19] We would go further and insist that the situation since 1929 has clearly been one in which the government was called upon to do everything in its power to promote recovery to a higher level of income and employment. It may reasonably be asked, however, whether a public spending program is the only or even the best means of attaining this end. Accordingly, in this section we subject the arguments for public spending as a recovery

[19] It is conceivable that the "leverage" effects of a given volume of expenditure will be greater for direct than for indirect or work relief; but extra-economic considerations weigh so heavily that we feel safe in making this statement.

measure to critical examination. In the following section we point out some of the practical problems involved.

The Mechanism of Income-raising Effects of Public Spending

Perhaps the most significant feature of the "multiplier" theory so far as spending policy is concerned is the need for continued spending in order to maintain the higher level of income. Once the spending stops, according to a pure "multiplier" theory, income reverts to its former level.

The magnitude of the rise in income with a given rate of expenditure depends upon the proportion of new income that is spent on domestic output—the "marginal propensity to consume." New income may fail to be spent on domestic output by being saved, by being absorbed into a rise of security prices, by being used to repay debts, or by being used to buy imports from abroad in such a way that exports are not increased. These ways in which new income escapes re-spending are called "leakages." As income rises, the proportion which is saved will, in all likelihood, rise. The chances are that the amount of money absorbed into financial circulation will also rise. Imports from abroad will tend to rise, but the ultimate effects of increased imports cannot be determined without taking into consideration any consequent increases in exports. Repayment of debt will probably be a substantial "leakage" in the beginning of an upswing and tend to become less important as debts accumulated during depression are paid off. On the other hand, induced extension of consumers' credit, which may make possible an increase in consumption greater than the increase in government-created income in any period may tend to increase as income rises. As noted above, such induced effects, strictly speaking, fall outside the "multiplier" concept. On balance, due to the relatively great importance of increased savings, it seems more likely that the "leakages" will grow as income rises, so that the "marginal propensity to consume," instead of remaining constant as is assumed in the "instantaneous multiplier" theory, will tend to fall. Such being the case, government expenditure must proceed at an *increasing* rate if the higher level of income is to be maintained. Analysis is complicated by the possibility that not only the amount consumed out of a given *increase* in income will change as income rises,

but even the amount consumed out of a given income. The whole consumption junction may change.

With respect to the acceleration principle and the "relation," we can say something more definite about cyclical behaviour. In the first place, it is clear that the pure acceleration principle can operate only where there is no excess capacity, but where there is still some unemployment of labor and other resources. So long as excess capacity exists, the increase in demand for consumption goods can be met by using more labor and raw materials in conjunction with previously idle plant and equipment. There is no need for any expansion of plant in any stage of production. On the other hand, once labor and other resources are fully employed, there is no possibility of increasing both consumption and investment simultaneously. Any actual increase in consumption must be accompanied by a decline in production of capital goods. Thus the acceleration principle proper can operate only in that stage of recovery where excess capacity has been absorbed but in which there is still some unemployment of other resources.

The "relation" may operate over a slightly broader range of conditions. If the increase in consumption in one field creates expectations favorable to investment in other fields, investment can take place even with excess capacity in the industry which first feels the new demand. If the new investment takes the form of producing a new commodity, the success of which leads to a wave of followers in the manner emphasized by Professor Schumpeter, a substantial boom may develop without ever absorbing the excess capacity in the industry first feeling the increased demand. It remains true, however, that actual consumption and investment cannot both expand once full employment is reached, except in monetary terms. If consumption is increasing in monetary terms but not in real terms conditions of a dangerous inflationary boom are present.

While the outcome of a spending program under the assumption of constant multiplier and relation coefficients may be of different types (depending upon the relative magnitude of the coefficients) allowance for variability of these coefficients and for changes in induced investment and consumption will result in a bewildering range of possible fluctuations. The lack of certainty as to just how these coefficients will vary makes prediction almost impossible. There is a good chance that any

strong movement in any direction will become cumulative, if only by creating expectations that the movement will continue in that direction. When people expect a boom and spend or invest accordingly, a boom results, and vice versa. Thus there is strong danger that we shall get either a dangerously inflationary boom or a relapse into depression. The problem of maintaining a high level of income will be discussed below.

Pump-priming effects of public spending will result where both "multiplier" and "relation" are high at the beginning of the upswing, and where induced private investment or consumption increases as fast as public spending tapers off. It is a condition in which recovery is likely to develop spontaneously before very long, if only because of the growing need for replacement. This argument for spending is little more than an expression of the conviction that long depressions are worse than short ones, and that it is worth spending some money to bring recovery sooner. However, from this point of view, it is highly doubtful whether it is necessary or desirable to wait until the conditions where pump-priming will work are present before starting to spend. There is, indeed, one school of thought that would support such a policy. This school regards the depression as a painful but necessary elimination of the disproportionate expansion which characterized the preceding boom and any attempt to alleviate the depression before it reached the bottom merely delays the ultimate cure. The pump-priming doctrine fits admirably with this point of view; we must wait until the bottom is reached and then a small injection of life-giving income into the system of our economic patient starts him on a rapid recovery. However, not all economists are agreed that a boom is a period of overinvestment or malinvestment. Some think it is just a period of large amounts of investment, and stops because investment stops; the sole problem is to start investment going again. From this point of view, spending should be started immediately a downturn appears.

Our own point of view would fall somewhere in between the two extremes discussed in the preceding paragraph. We feel that a boom does involve some maladjustment, which can be cured by a moderate and limited deflation. We also feel that an uncontrolled deflation is likely to proceed too far, and to do more harm than good. The difficulty is in recognizing the

proper point to check the deflation, and to do so effectively once it is under way.

Neither the multiplier nor the relation take sufficient account of replacement waves. The multiplier is not concerned with them at all, the relation assumes a more or less constant rate of replacement, the upswing being explained by the addition of new investment to this replacement. In fact, an upswing may occur through a sudden increase in replacement demand when consumption does not increase, but is only maintained. The concept of "induced investment" includes any such replacement waves, which are brought on by public spending which does not actually increase consumption but only maintains it.

There are some problems here, however. Ought the "multiplier" to be restricted to net investment? It is surely possible that a mere increase in the rate of replacement will prove to be income-creating, and that the ultimate rise in income will be a multiple of the initial rise. A decline in the volume of replacement expenditures, similarly, may result in a multiple fall in current income, if the funds previously used for replacement are added to idle depreciation reserves. If funds already accumulated for replacement purposes merely remain in their present form, without causing any further reduction in the volume of replacements, then there seems to be no reason why income should actually fall; it only fails to increase. If replacement funds are distributed as dividends and spent on consumption, so that capital is being "consumed," the net effect may well be a rise in national income.

The above discussion suggests another complication; "leverage" effects will in all probability be different according to the nature of the expenditure project. If, for example, the government buys finished products from industries with considerable excess capacity and whose entrepreneurs hoard any profits that they gain thereby, the secondary effects are likely to be very small. If they place income in the hands of unemployed who spend it all on products of industry with no excess capacity, the effect will be great. A sudden and sharp increase in spending, whether by government or by recipients of government-created income, is likely to raise profit expectations more and lead to a greater amount of induced private investment than a slower rate. This result will be all the more likely if

rigidities in the supply of capital goods prevent an immediate response to the increase in demand, so that a wide profit margin appears in capital goods industries as well.

Our analysis in this section has tried to demonstrate that the various mechanisms by which government spending leads to a more than proportionate rise in income are not so simple as may appear at first sight. So far, however, we have not questioned that such a rise in national income will result, at least temporarily. We must now turn to a consideration of possible adverse effects on private enterprise.

Public Spending and Business Reaction

There is no gain from the spending policy if the resulting increase in employment in one industry is offset by an induced decline of employment in some other industry. It is conceivable that the latter effect might more than offset the former, so that total leverage would be negative. The reaction of private enterprise to the spending policy is thus of importance not only as a determinant of the factors upon which the size of the multiplier and relation coefficients depend (e.g. the scale of leakages and the anticipated return to investment), but also as a determinant of those additional (positive or negative) leverage effects which remain outside the concepts of multiplier and relation proper.

(1) A most important factor to be considered in this connection is business psychology,—most important in spite of its highly intangible character, rendering its inclusion into neat analysis well nigh impossible. As long as employment and the creation of income are largely dependent upon business decisions, the considerations (whether rational or irrational) which are behind these decisions are of supreme importance. Now, there is no doubt that the element of confidence is a prime factor in the formulation of these decisions,—confidence in the predictability as well as profitability of future business conditions. The effects of the spending policy upon the state of confidence form, thus, an integral part of the issue of deficit finance. Certain aspects of the confidence problem may be distinguished:

Confidence may be disturbed by the fact that deficit finance introduces an additional element of uncertainty into the economic system. In so far as improved conditions depend upon

the continuation of the policy and this continuation itself appears doubtful, the business community may be hesitant to base any long term commitments on what is considered an essentially short term recovery. A forceful policy with visible results will do more to overcome apprehension than an apologetic tampering with deficit finance. A continuity of public policy is essential.

Confidence may be shaken by justified apprehension for the long-run consequences of continued deficit finance, to be discussed in a later section. The future possibility of heavily increased taxation or of a critical turn in the state of public credit with its possible inflationary implications are not inducive to the making of long term commitments. In so far as continued deficit finance bears the seeds of its destruction, this future event is to be anticipated in present investment policies of business.

While continued deficit finance will be shown to entail very definite dangers, there is no doubt that these can be greatly overestimated, particularly for the not too distant future. The confidence disturbing effects of deficit finance may be minimized by creating a better understanding of its implications on the side of the business community. This is especially important in regard to unwarranted fears of imminent inflation and consequent increased holding of idle cash in spite of the fact that orthodox theory would suggest investment rather than liquidity as the adequate means of meeting potential inflation. Elimination of unjustified fears and safeguards against justified apprehension are both highly important for a successful spending policy.

While much may be accomplished in this direction, the policy of deficit finance can not be expected to be free of the broader social and political implications, implicit in the expansion of government activity. On the one hand, public participation in the economic sphere is a prerequisite for the maintenance of the private enterprise system; on the other hand, the shifting framework which such participation easily entails may undermine the basis upon which the very system is built. If the policy of deficit finance is viewed in the light of this conflict, the need for utmost reduction of possible offsetting effects and for a minimization of leakages becomes an essential part of the policy.

(2) There is one group of business men who are particularly concerned with the present program of government spending through deficit financing; those connected with financial houses, including commercial banks, savings banks, and insurance companies. These concerns, more or less committed to "conservative" investment policies, have met the increasing uncertainty as to the return and safety of private investment by holding larger and larger amounts of governments, particularly Treasury obligations. In June 1938 about 40 per cent of all Member Bank assets, 18 per cent of life insurance assets and 23 per cent of Mutual Savings Banks assets were in the form of federal securities. In all, these holdings amounted to 51 per cent of outstanding federal obligations.[20]

As the government continues to borrow to finance its spending program, it must appeal to less eager investors, who will be tempted to part with their cash balances only by the prospect of higher and higher yields; that is, the government securities will be sold at greater and greater discounts. This decline in the value of new issues (rise in yield) results in a decline in the value of outstanding government securities. Consequently, the true market values of bonds and notes held by financial institutions falls further and further below the book value. If the time should come when the banks want to liquidate these bonds in order to build up their reserves for commercial loans, the decline in the market value of the bonds will be accentuated. It is little wonder that, in the face of such a situation, the bankers are inclined to worry.

(3) Next, there is the problem of government competition with private investment, in both the product and the resources markets. A conflict may arise between the choice of projects on the basis of their usefulness or degree of competition which they provide. As far as competition in the product market is concerned, there is little doubt that it should and can be avoided. The advantages of providing "yardsticks" for private enterprise in the form of public competition will in most cases be more than offset by their discouraging effects, quite apart from the theoretical difficulties of conducting such policy on a fair basis. Public works, as well as government owned cor-

[20] T.N.E.C. Hearings, Part 9, *Savings and Investment*, p. 4056. The percentage figures for life insurances and Mutual Savings Banks are derived from tables on p. 4052 and p. 4098. If indirect obligations are included the total holdings of these institutions amounted to 53 per cent of outstanding securities; *loc. cit.* p. 4098.

porations, should thus be established in those parts of industry where the competitive factor is minimized. The conflict between this criterion and the desirability (discussed below) of directing public outlays into self-liquidating investments remains for later consideration.

In the factor market, the elimination of competition between public and private purchasers proves a great deal more difficult. Less circumspect advocates of public spending are inclined to argue that during a period of relative inactivity, there are no scarce resources. Such is far from the truth. Certain raw materials, certain kinds of skilled labor, even free capital for certain types of investments (particularly those of a risky sort) are scarce during such periods in the sense that the demand for them is not totally inelastic and their supply is not completely elastic. In so far as the government uses these resources in its spending program, it is competing with private enterprise and tends to raise costs and to restrict output.

Labor cost is most important in this connection for the mere reason that a high percentage of emergency outlays take the form of direct payments to labor. The problem will be most acute where the government bids for a scarce labor supply, but its application is much more general. The rate of relief payments and work relief wages set an effective bottom to wage rates in private industry and thus support the downward rigidity of wage adjustments. The acceptance of union rate scales for work relief wages is harmful where a decline in wage rates would result in increased employment and a larger wage bill. To the social significance of wage receipts must be added the consideration of wages as a cost factor. The conclusion is inevitable that the intensification of wage rigidities due to public spending may be one of the most important "offsetting" forces.

(4) The problem of public competition for available savings is primarily qualitative. In regard to the quantitative aspect of the picture, we note that there is a limit to the drain of capital (considering the aggregate of savings funds entering into the capital market) away from private investment. If a constant propensity to consume is assumed, the multiplying effects of public spending resulting in a raised level of income will also cause a "replenishing" of the capital fund available to private investment; the extent to which the capital drain will cease and

the rate at which it will fall off depends upon the degree to which new savings are made available for the capital market. If it is assumed that the entire income which is not consumed is made thus available, it follows that with a constant rate of deficit spending the resulting drain of capital from the private capital market is limited quantitatively as well as in time. The increase in private capital cost has thus an upper limit. If a private demand for funds emerges, the government could moreover reduce its borrowing accordingly,—not, however, without facing the resulting deflationary effects. As pointed out initially, this analysis does not yet account for the qualitative aspects of the competition for capital.

(5) The appearance of "bottle necks" during an upswing period presents difficulties, whether the recovery be government-financed or spontaneous. The relative scarcity of certain resources, the limited ability of adjustment in the short run and, finally, the development of monopolistic positions in the upswing are forces operative with or without government spending. The spending policy, however, may reduce or accentuate these difficulties. An increase in the supply of relatively scarce types of skilled labor through public training programs (conducted perhaps by the C.C.C.) might greatly contribute to a smoother recovery movement. So might reduction in public demand for scarce resources (labor or otherwise) at a time of increasing private demand. The opposite—an increase in public demand for scarce resources—will contribute to excessive cost increases and an earlier halt in the recovery movement.

The rate of government spending and of its induced recovery may have some effect upon the development of "bottle necks," —a slow recovery will contain less danger of maladjustments than a rapid one. But this does not mean that expenditures should be cut down as soon as "bottle necks" appear, since the resulting decline in income may more than offset the advantage of a specific price adjustment. Instead the problem is one of supplementing the spending policy with other measures, making for an orderly expansion of private output.

Maintaining Stability

We will now suppose that the government has succeeded in raising income and employment to a high level. Ideally, this level at which income is stabilized would be the "full-employ-

ment equilibrium" level, as we have defined it above; that is, the highest level which is possible without the maladjustments inherent in inflation. It must be admitted at the outset, however, that the problem of defining and recognizing the conditions of "full-employment equilibrium" is an exceedingly difficult one, one which deserves separate treatment. For the time being, we shall assume merely that the government has previously embarked upon a spending program which has evidently been effective in raising national income. The question is, will this higher level continue of its own accord, or must the government undertake measures to maintain it and to prevent a relapse?

Supporters of the spending policy will quite rightly point out that to suggest a danger of reaction from government-induced prosperity is no criticism of the policy. Even a "spontaneous" recovery may not—indeed, probably will not—be self-sustaining over a long period. On the other hand, it would be misleading if this danger were not pointed out at all, leaving the impression that once recovery has been achieved the responsibility of the administrative authority is finished. Government spending is no economic panacea. The administration should face the problem of maintaining as well as attaining a high level of income and employment, and be prepared to take whatever measures are necessary.

From our previous analysis, it is clear that the *approach* to full employment is itself strewn with nasty pitfalls. Each successive "bottleneck" requires the administration to proceed with extreme care, balanced precariously between the relapse that will result from too little spending and the inflationary boom that will result from too much. Public spending must taper off (or increase) at just the rate at which private investment and consumption increases (or decreases). If it tapers off too fast (increases too slowly) there will be a recession; if it tapers off too slowly (increases too fast) there will be overexpansion, which will lead to subsequent breakdown. Add to these difficulties of keeping the proper balance in the system as a whole the danger of disproportionate expansion in each stage or branch of industry, which necessitates careful attention to developments in every sector of the economy, and some idea of the magnitude of the problem is obtained. We will assume

for the sake of argument that these transitional difficulties have been overcome.

(1) Suppose, first of all, that the high level of income and employment has been reached by pump-priming. A modest and temporary spending program has produced enough induced investment and consumption to yield a substantial recovery. Under these conditions, the most pressing question is the same one that constitutes the most controversial issue in ordinary business cycle policy: should the boom be checked or prolonged? The difference of opinion on this subject relates to economic history rather than to economic analysis. Do we in the real world, tend to go beyond the point of "full employment equilibrium" into an inflationary boom, characterized by over-investment made possible by over-extension of credit and which contains within itself the seeds of inevitable breakdown? Or have we, even at the height of a boom like that of 1920's, plenty of unemployed resources still available for continued expansion? It is our opinion that the latter view is too optimistic, underestimating the degree of rigidity in the economic system, the difficulty of overcoming "bottlenecks," the scarcity of certain key resources like skilled labor. Be that as it may, it is clear that if pump-priming has been successful, there are no *additional* problems of cycle policy arising merely out of the fact that the boom was set off by government spending. There is no need even for a net rise in public debt. With rising national income, tax revenue may well increase enough to permit redemption of the debt incurred in the temporary spending program.

(2) If the high level of income and employment is reached through a pure "multiplier" reaction, the general policy to be pursued is perfectly clear: continued spending. The only questions are, *how* to spend, and *how much* to spend? With respect to the first question, it must be decided what forms of expenditure will be most effective in preventing the expectations of business men from being disappointed. If, for example, over 50 per cent of sales of cement during the recovery period have been to the government, as was the case in this country between 1933 and 1937, it would be most unwise to abandon construction projects altogether. Thus the kind of expenditure which must be undertaken is determined largely by the kind of expenditure which *has been* undertaken. Where any freedom exists, the

administration should base its choice of projects on the relative effectiveness in creating income and on the social utility of the project itself.

With an approach to full employment, continued public works spending raises increasingly the danger of public competition with private bidding for resources. Inasmuch as a high level of *private* employment is the policy objective, a situation in which continued spending proves necessary will require in the later stages of the program a shift from public works outlays to cash subsidies or purchases from industry. Tax reduction and loan finance of previously tax-financed outlays, together with a reduction of previously loan-financed public works outlays offers an alternative solution.

The question of "how much" must be answered mainly on the basis of the course of the "marginal propensity to consume" (proportion of new income re-spent) during the upswing. We have argued above that the most likely course will be for it to decline as income rises. Such being the case, the rate of spending must gradually increase during the upswing—the exact rate of increase being practically impossible to determine; or else the spending program must be supplemented by a policy to maintain the propensity to consume, say by redistribution of income in favor of the lower income groups. This policy presents problems of its own, especially the danger that high and progressive taxes will reduce the volume of investment.

Once the maximum level of income for a given initial expenditure has been reached, it can be maintained by a constant rate of expenditure. Income would then no longer be increasing, so that the rate of re-spending would not be decreasing. But a further increase in spending might raise income still more. Thus the question mentioned in the opening paragraph of this section comes to the fore; is the level of income that has been reached the "full-employment equilibrium" level? Will a further increase in spending increase real income, or only money income? Raising money income alone means inflation, with all the dangers that the term implies; yet to forego a possible rise in real income is also undesirable.

A related problem is to decide whether the "multiplier" reaction has substantially run its course,[21] so that a constant rate

[21] Strictly speaking the full effects of the "multiplier" could be reached only after an infinite lapse of time; but 99.9 per cent of the effects will be attained in finite periods of varying duration.

of spending will suffice to maintain income henceforth or whether it is still operating, so that an increasing expenditure is still necessary. This problem is made more difficult by the fact that for a limited number of income-periods, the rise in national income may be small even though the "multiplier" is actually very high; the period necessary for the "multiplier" to come within a small percentage of its ultimate effects is longer, the greater the "multiplier." Thus, an administration, after a certain period of spending, and noting a certain rise in income, would be hard put to decide whether the "multiplier" was small and had nearly worked itself out or whether it was large and had still a long time to run. Yet the two situations call for two different kinds of policy; the former, relatively constant expenditure; the latter, increasing expenditure.

(3) If the high level of income and employment has been reached via the "relation" or the "acceleration" principle, the outlook is still more gloomy. It can be shown that a boom based upon investment induced by increasing consumption can turn into a slump through a mere decline in the rate of increase in consumption.[22] It is conceivable that replacement requirements will grow just fast enough to offset the tapering off of consumption; but this would be a lucky accident. Clearly, consumption cannot possibly increase indefinitely, let alone increase at a constant rate, except in a purely monetary sense, which sooner or later implies inflation. It would seem, therefore, that if a boom is based entirely on the "relation," and investment continues to be based upon increases in consumption throughout the upswing, a downturn is well nigh inevitable.[23] There

[22] To illustrate this principle, for the benefit of those to whom it is not familiar, we can use a simple arithmetic model. Suppose $2000 worth of consumers' goods are being produced and sold annually in a plant worth $10,000. consisting of 100 machines, worth $100 each. Every year ten machines wear out, and must be replaced, and $1000 worth of labor and raw materials bring total cost of the output up to $2000. The ten machines are produced annually by the "capital goods industry." Now suppose demand for consumers' goods increases by 10 per cent to $2,200. The "consumers' goods industry" now needs a plant of 110 machines. Thus in that period the demand for machines is doubled; ten machines are replaced and ten additional ones are bought. The capital goods industry accordingly doubles its plant. Now suppose that in the following period demand for consumers' goods increases 5 per cent to $2,310. A plant of 115.5 machines is required; so 16.5 machines are demanded, 11 to replace those worn out in the previous period and 5.5 additional ones. The capital goods industry, designed now to produce 20 machines annually, is overexpanded.

[23] Frisch's argument that rising replacement demand may offset a falling increase in consumers' demand has less significance the greater the number of interrelated stages of production.

is nothing the spending authority can do to prevent an ultimate relapse while the boom is under way.

If the downturn in investment does not itself become cumulative, the government may be able to maintain the level of consumption at the maximum by providing workers and entrepreneurs with incomes as fast as their jobs and business disappear. In this manner an equilibrium may be established when the capital structure has shrunk enough, through liquidations and failure to replace all of existing plant, that the remaining plant and equipment is just sufficient to provide that level of consumption. Such a procedure, however, involves continuous government spending. If the government lets incomes fall, consumption will decline and investment will be reduced in greater proportion. Moreover, consumption must be maintained in the same fields in which investment has taken place, and in proportion to the investment. There seems to be no way of accomplishing this end except outright purchases of finished goods from private industry, to be distributed among the unemployed and among the entrepreneur-capitalists whose incomes have fallen; for if the government competes in either the factor market or the commodity market with private enterprise by engaging in any kind of production, the situation of private enterprise is injured, so that the volume of expenditure necessary to maintain income is increased still more, leading into a vicious circle.[24] Obviously, such a "dole" would be abhorrent to the majority of people in this country and real income would be below the full-employment level. The ideal policy, of course, would be for the government to let consumption taper off at just the rate that replacement demand rises; but even if it were possible to ascertain what that rate was, it may prove impossible to prevent a faster rate of decline. On the whole, it seems preferable to limit the rise in consumption from the beginning, in order to alleviate the difficulties of maintaining stability later on.

(4) When we make the more realistic assumption that the success of the spending program in raising income and employment has been the result of the combined action of "multiplier" and "relation," plus any induced investment or consumption

[24] Two-price systems, such as the food-stamp plan, may succeed in absorbing output of private enterprise without lowering market prices.

not properly included in these concepts in their strictest form, the trials of the spending authority are multiplied. Some idea of the complications inherent in this case will have been gleaned from the discussion of "leverage" in previous sections. So varied are the possible reactions for different relationships between "relation" and "multiplier" effects, particularly when it is realized that these coefficients themselves change in the course of the upswing in an irregular manner, that it is impossible to tell merely from the results in terms of income or employment what is going on or what is likely to happen in the future. Yet such knowledge is essential to proper handling of the process. If, for example, the current rise in income is due largely to operation of the "relation" and the "multiplier" has worked itself out or is very low, it would be advisable to institute some controls to prevent over-expansion of the capital goods industries—controls which may not fall within the jurisdiction of the spending authority—such as central bank rediscount rate. If, on the other hand, the current rise is due almost entirely to the "multiplier" and the rate of re-spending is diminishing, spending ought to be speeded up. The administration is walking on a narrow fence between recession and inflation; to fall either way means a need for new measures to restore balance.

It is possible that even if the administration knows the past and future course of the "leverage" coefficients, it may be unable to maintain stability. As we have suggested above, once the structure of production is adapted to a certain form as well as a certain volume of government expenditures, it may be impossible to cut down on expenditures in any field without disappointing a large and important group of business men, imposing losses upon them and sowing seeds of recession. Yet, just to the extent that the government is successful in stimulating private enterprise in fields not directly dependent upon government spending, the difficulty of maintaining purchases from the industries more dependent upon government expenditures increases. For if government activity—say in construction—is continued in the face of increasing scarcity of resources, rising costs of production are the inevitable result. The government finds itself in a dilemma; either it disappoints expectations of business men dependent upon government purchases,

or it disappoints expectations of others through raising costs above the level that was anticipated. This kind of dilemma is the more likely to arise the more significant the "relation" has been in producing the existing level of income and employment.

It is time now to introduce a new problem. Throughout our discussion we have talked about the task of attaining and maintaining a high level of income *and* employment. For this coupling of income and employment there is undoubtedly plenty of precedent in recent literature. Yet it must be recognized that a rise in employment and a rise in *real* income do not always go hand in hand. To take an extreme case, it would be possible to put *all* the unemployed to work piling up stones and pulling them down again; which would not raise real income a whit.[25] It is clear that in the case of Germany between 1933 and 1939, real income did not rise in proportion to the rise in employment—unless one can count armaments as real income. If a country which already has a high level of employment embarks upon an armament program, withdrawing men from other fields of enterprise at the same time that it absorbs unemployed, real income and employment move in opposite directions. Whenever men move from occupations where their productivity is high to occupations where their productivity is less high, there is a sort of "disguised unemployment," which takes the form of a fall in the standard of living. If W.P.A. projects serve to keep men out of private enterprise where their productivity is higher, then these projects produce "disguised unemployment," and the standard of living or real income is lower than it would be without this form of government expenditure.

This discussion brings us back to the question of criteria for "full-employment equilibrium." Clearly, the number of men seeking employment is not a satisfactory indicator of the extent to which "full-employment" has been achieved, even if men working directly on government projects were to be counted as unemployed. "Full employment" is an ever-changing figure, depending on variations in all phases of economic activity.[26]

[25] If only some of the unemployed are put to work in this manner, the spending of their incomes may result in the absorption of other unemployed into private enterprise, thus raising real national income.

[26] As for instance changes in the general level of skill, technical progress, changes in tastes, intensity of trade union activity, size and composition of population, the terms of foreign trade and other factors.

The National Debt, Taxation, and Paper Money

No evaluation of deficit finance is possible without consideration of its most important aftermath, the public debt. The growth of the federal debt from slightly above 16 billion dollars in 1930 to over 43 billion dollars in the first half of 1940, raising the total public debt to well over 60 billions, is frequently considered the most serious aspect of New Deal finance. Since the rising trend of state and local debts prevailing during the twenties was discontinued during the thirties, part of the increase in the federal debt may be explained as a substitute for the former. The statistical side of this development is presented in Tables 1 and 2.

TABLE 1
OUTSTANDING U. S. FEDERAL INTEREST BEARING DEBT

	Direct and Guaranteed Debt (Millions of Dollars)						
	Direct Debt Gross	Guaranteed Debt Gross	Direct and Guaranteed Debt Gross	Amount Held by Federal Agencies and Trust Funds	Total Net Debt[a]	General Fund Balance	Total Net Debt Minus General Fund Balance
For year 1922	22,711	730	23,441	1,116	22,325	272	22,053
" " 1926	19,384	1,659	21,043	1,138	19,905	210	19,695
" " 1929	16,639	1,867	18,506	1,205	17,301	327	16,974
" " 1932	19,162	1,780	20,942	2,510	18,432	417	18,015
" " 1936	35,803	10,547	46,350	12,153	34,197	2,682	31,515
" " 1939	39,892	7,988	47,880	9,811	38,069	2,838	35,231

Source: U. S. Treasury, *Annual Report*, 1939.
[a] Total outstanding issues, direct and guaranteed, less those held by U. S. Government, Federal Trust Funds and Agencies, Federal Reserve Banks and in Sinking Funds of States, Localities, Territories and Insular Possessions.

TABLE 2
OUTSTANDING STATE & LOCAL DEBT IN U. S. 1922–1939

	Gross and Net (Millions of Dollars)	
	State and Local Gross	State and Local Net[a]
For the year 1922	9,893	8,565
" " " 1926	13,604	11,775
" " " 1929	16,760	14,479
" " " 1932	19,330	17,930
" " " 1936	19,212	17,317
" " " 1939	19,626	15,157

Source: U. S. Treasury, *Annual Report*, 1939.
[a] Total outstanding issues, direct and guaranteed, less those held by U. S. Government, Federal Trust Funds and Agencies, Federal Reserve Banks and in Sinking Funds of States, Localities, Territories and Insular Possessions.

Misconceptions and folklore abound in public discussion of the issue. Two of the more important fallacies may be disposed of at the outset. First, there is the contention that public bor-

rowing is bound to bring disaster for the mere reason that no private individual can "get away" with a continuous policy of borrowing. Actually the resources available to the government are altogether different from those available to the private individual and no parallel of this sort exists. Secondly, there is the equally fallacious proposition that the problem offered by public borrowing and spending is quite similar to that of investment in fixed corporate obligations. This analogy is tenable in the limited case of fee-yielding public investments only and does not hold where public spending is directed at the supply of non-fee-yielding public properties.

(1) Among the various implications of a rising public debt the problem of debt service, including interest payments and redemption, is the most apparent. Interest payments require collection through taxation of the necessary funds: As seen from Table 3, the "alternative" of loan-finance of interest service will result in a cumulative rise in the capital debt, at a rate much in excess of what may appear desirable to even the most optimistic spender. As a continuous policy, loan finance of interest charges must be excluded from responsible discussion. The balancing of interest finance over the cycle is a different matter.

TABLE 3

HYPOTHETICAL INCREASE IN DEBT

Column I: Increase by $2.5 billion per annum and tax-finance of interest charges.

Column II: Increase by $2.5 billion per annum and loan-finance of interest charges. Average interest rate of 2 per cent.

Column III: Increase by $2.5 billion per annum and loan-finance of interest charges. Average interest rate of 3 per cent.

Amount of Debt for the Year (in billions $)

	I	II	III
1940	45	45.0	45.0
1950	70	80.9	90.4
1960	95	125.9	146.9
1970	120	181.9	226.9
1980	145	251.9	332.9
1990	170	334.9	462.9
2000	195	435.9	650.9
2010	770	558.9	902.9
2020	745	718.9	1232.9
2030	270	902.9	1687.9
2040	295	1117.9	2302.9
2050	320	1489.9	3124.9

The volume of future interest obligations will depend upon the rate of debt increase and the course of future interest rates. For the fiscal year 1940, a capital debt of approximately $43 billion and an average interest rate of 2½ per cent calls for an interest service of about $1.1 billion;[27] in the fiscal year 1931, an interest bearing debt of about $16.8 billion and an average interest rate of 3.6 per cent called for interest obligations of $611 million. The decline in interest rates thus considerably offset the increase in debt capital. Speculations regarding future interest burden based on varying assumptions in respect to the rate of debt increase and the level of interest rates is aided by reference to Tables 4 (a) – (e). On Table 4 (b), we see that a continued increase of the debt at the rate of $25 billion per decade (a rate slightly below that of the thirties), and a continued average interest rate of 2½ per cent, would saddle our federal budget with annual interest obligations of $1.7 billions by 1950, $3 billions by 1970 and $4.9 billions by the year 2000. For interest rates of 3 or 4 per cent the charges are seen to be correspondingly higher.

TABLE 4

(a) Hypothetical Total of Outstanding Debt

(*Billions of Dollars*)

	Rate of Increase per Decade		
	10	20	25
For the year 1940	45	45	45
" " " 1950	55	65	70
" " " 1960	65	85	95
" " " 1970	75	105	120
" " " 1980	85	125	145
" " " 2000	105	165	195
" " " 2050	155	265	320

(b) Resulting Annual Interest Charges

(*Billions of Dollars*)

Rate of Interest %	1			2½			3			4		
Debt Increase per Decade	10	20	25	10	20	25	10	20	25	10	20	25
Year 1940	.45	.45	.45	1.12	1.12	1.12	1.35	1.35	1.35	1.80	1.80	1.80
" 1950	.55	.65	.70	1.37	1.62	1.75	1.65	1.95	2.10	2.20	2.60	2.80
" 1960	.65	.85	.95	1.62	2.12	2.37	1.95	2.55	2.85	2.60	3.40	3.80
" 1970	.75	1.05	1.20	1.87	2.63	3.00	2.25	3.15	3.60	3.00	4.20	4.80
" 1980	.85	1.25	1.45	2.12	3.12	3.62	2.55	3.75	4.35	3.40	5.00	5.80
" 2000	1.05	1.65	1.95	2.62	4.12	4.87	3.15	4.95	5.85	4.20	6.60	7.80
" 2050	1.55	2.65	3.20	3.87	6.62	8.00	4.65	7.95	9.60	6.20	10.60	12.80

[27] Cf. President's Budget Message, January 1940. Does not include proposed borrowing for financing of preparedness program.

(c) Annual Interest Charges as Percentages of National Income
Assuming Debt Increase of $25 Billions per Decade

Rate of Interest	1			2½			3			4		
National Income	70	80	100	70	80	100	70	80	100	70	80	100
For the year 1940	.6	.5	.4	1.6	1.4	1.1	1.9	1.7	1.3	2.6	2.2	1.8
" " " 1950	1.0	.9	.7	2.5	2.2	1.7	3.0	2.6	2.1	4.0	3.5	2.8
" " " 1960	1.3	1.2	.9	3.4	3.0	2.4	4.1	3.6	2.8	5.4	4.7	3.8
" " " 1970	1.7	1.5	1.2	4.3	3.7	3.0	5.1	4.5	3.6	6.8	6.0	4.8
" " " 1980	2.1	1.8	1.4	5.2	4.5	3.6	6.2	5.4	4.3	8.3	7.2	5.8
" " " 1990	2.4	2.1	1.7	6.0	5.3	4.2	7.4	6.5	5.2	9.7	8.5	6.8
" " " 2000	2.8	2.4	1.9	6.9	6.1	4.9	8.3	7.3	5.8	11.1	9.7	7.8
" " " 2050	4.6	4.0	3.2	11.4	10.0	8.0	13.7	12.0	9.6	18.3	16.0	12.8

(d) Annual Interest Charges as Percentages of National Income
Assuming Debt Increase of $20 Billions per Decade

Rate of Interest	1			2½			3			4		
National Income	70	80	100	70	80	100	70	80	100	70	80	100
For the year 1940	.6	.5	.4	1.6	1.4	1.1	1.9	1.7	1.3	2.6	2.2	1.8
" " " 1950	.9	.8	.6	2.3	2.0	1.6	2.8	2.4	1.9	3.7	3.2	2.6
" " " 1960	1.2	1.1	.8	3.0	2.6	2.1	3.6	3.2	2.5	4.9	4.2	3.4
" " " 1970	1.5	1.3	1.1	3.7	3.3	2.6	4.7	3.9	3.1	6.0	5.2	4.2
" " " 1980	1.8	1.6	1.2	4.4	3.9	3.1	5.3	4.7	3.7	7.1	6.2	5.0
" " " 1990	2.1	1.8	1.4	5.2	4.5	3.6	6.2	5.4	4.3	8.3	7.2	5.8
" " " 2000	2.4	2.1	1.6	5.9	5.1	4.1	7.1	6.1	4.9	9.4	8.2	6.6
" " " 2050	3.9	3.3	2.6	9.4	8.3	6.6	11.4	9.9	7.9	15.1	13.2	10.6

(e) Annual Interest Charges as Percentages of National Income
Assuming Debt Increase of $10 Billions per Decade

Rate of Interest	1			2½			3			4		
National Income	70	80	100	70	80	100	70	80	100	70	80	100
For the year 1940	.6	.5	.4	1.6	1.4	1.1	1.9	1.6	1.3	2.6	2.2	2.8
" " " 1950	.7	.6	.5	2.0	1.7	1.4	2.3	2.0	1.6	3.1	2.7	2.2
" " " 1960	.9	.7	.6	2.3	2.0	1.6	2.7	2.4	1.9	3.7	3.2	2.6
" " " 1970	1.0	.9	.7	2.7	2.4	1.9	3.1	2.7	2.2	4.3	3.7	3.0
" " " 1980	1.1	1.0	.8	3.0	2.6	2.1	3.6	3.1	2.5	4.9	4.2	3.4
" " " 1990	1.3	1.1	.9	3.4	3.0	2.4	4.0	3.5	2.8	5.4	4.7	3.8
" " " 2000	1.4	1.2	1.0	3.7	3.2	2.6	4.4	3.9	3.1	6.0	5.2	4.2
" " " 2050	2.2	1.9	1.5	5.5	4.8	3.9	6.6	5.8	4.6	8.9	7.7	6.2

The implications of any given volume of interest charges and, hence, tax burden, depend upon the comparative size of the taxable national income, the amount of taxes collected for other purposes, and the technique of tax collection employed. As a first approximation to an intricate problem we suggest that tax pressure will remain unchanged if the increase in interest charges is accompanied by a rise in taxable national income, sufficient to maintain the ratio between tax collection and taxable income. If interest charges increase at a faster rate, an increasing tax pressure will result and the higher the previous ratio of tax collection to taxable income, the more serious will

be the implications of any further increase in interest obligations.[28] Tables 4 (c) – (e) provide some estimates of these ratios, combining the previous assumptions regarding debt increase with further assumptions as to the level of taxable national income. The Tables indicate, for instance, that for the case of a continued rate of debt accumulation of 25 billion dollars per decade and an interest rate of 2½ per cent, interest obligations as percentage of national income of 80 billion dollars will amount to 3.0 per cent in 1960, 4.5 per cent in 1980 and 6.1 per cent in the year 2.00; for a 4 per cent interest rate and a national income of 100 billion dollars the corresponding percentages would amount to 3.8, 5.8 and 7.8 respectively.

The exact point at which the pressure of interest-financing taxes will become a severe detriment to the operation of private enterprise economy can not be determined easily; much depends on the volume of tax collection for purposes other than the financing of interest charges, and upon the way in which taxes are collected. A distinction between the short and the long run outlook is called for.

In 1939 federal tax revenues of 5.5 billion dollars amounted to 8 per cent of a national income of 68 billion dollars and 7.8 billion state and local tax revenues amounted to 11.4 per cent of the national income. Federal interest payments of 940 million dollars amounted to 1.4 per cent of the national income and to 17.1 per cent of the federal tax revenues, while state and local interest payments of an estimated 800 million dollars amounted to 1.2 per cent of national income and 10.2 per cent of state and local tax revenues.[29] Our calculations serve to show that for some decades to come this tax scene is not likely to be changed violently by increased revenue requirements for the purpose of financing interest service on a rising public debt, even if debt accumulation would continue to proceed at the pace of the thirties. This conclusion is the more justified since a rising tax base will produce a more than proportionate increase in tax yields and since some further revenue may be obtained through the tightening of tax laws and through ex-

[28] A further discussion of this point follows in the section on the budget.

[29] The Census figure for interest payments by state and local governments for 1932 is 884 millions. Since then there has been little change in the volume of state and local debts, but some decline in rates. The Treasury study on the *Securities Exempt from Federal Income Taxation as of June 1937* estimates the figure for 1937 at 795 millions.

ploitation of neglected revenue sources.[30] However, our calculations supply no definite answer to the question of the point at which the tax problem will become really critical, nor to the query whether this point has not already been reached.

While the short run dangers of the interest problem are easily exaggerated, the long run outlook (extending beyond, say, fifty years) is highly disquieting. For a number of reasons it is clear that continued debt accumulation will produce serious difficulties at some point, unless accompanied by a corresponding increase in taxable national income. If financed out of low income or sales taxes, a growing volume of interest charges will counteract the inflationary effects of a spending policy. If financed out of high income, capital or profit taxes, the debt service will depress the marginal efficiency of capital and thus interfere with the "leverage" of public spending. Moreover, the ratio of interest charges to taxable national income will be much larger in depression years than is indicated in our Tables, which are based upon an average national income. If a policy of balancing interest charges over the cycle is adopted the burden will be correspondingly heavier in prosperity years.

The major cause for worry is that the ratio of interest charges to taxable national income can not but rise if the deficit policy is to be continued for any length of time. This follows from the simple fact that with a given state of technique and supply of resources, a definite ceiling to further increases in the national income is reached at the "full employment" level. From the point of view of the interest-finance problem, the conclusion is thus inevitable that continued accumulation of an interest bearing public debt, the service on which must be financed out of taxes, breeds final disaster; the issue is only one of determining the danger point.

Two possible methods of escaping this dilemma remain to be explored. First, the question arises whether the problem of interest-finance can not be solved by way of directing public outlays into self-liquidating investments; second, there is the possibility of non-interest bearing public issues. The first al-

[30] Potential revenue sources still exist in the lower-middle brackets of the personal income tax, say from $3000 to $100,000 at which point the effective tax rate reaches 33 per cent; the inheritance tax, where the exceedingly high rates in the very upper brackets should be supplemented and possible relieved by a steepening of the progression in the lower (up to, say, $1,000,000) brackets; and finally in sales taxes of various sorts.

ternative deserves much consideration. Self-liquidating investments are defined as government outlays for the construction of durable goods (consumers' or producers' goods), the benefits from which may be sold to voluntary purchasers at a fee-price, sufficient to cover interest service and amortization of the sum invested. In so far as the debt service may be fee-financed in this manner, no tax problem exists and the above stated difficulties are overcome. If public investments are non-fee-yielding but productive in the sense of contributing to an increased taxable income, the need for tax-finance of interest will still prevail but its implications will be less severe.

At the present level of the national debt, any significant redemption out of general tax revenue would imply one of three alternatives: a vast self-sustained increase in taxable income, much higher tax rates, or large reductions in government expenditures. With neither of these alternatives in sight, the question of redemption is an academic one for the time being. Popular acceptance of the apparent inevitability of a large permanent public debt may contribute to the elimination of some of the psychological barriers in the way of successful deficit finance; but it also carries the danger of a waning awareness to the desirability of redemption if conditions permit.

A policy of balancing the budget over the cycle is in itself desirable, but can not be undertaken without regard for the economic effects of redemption which may be just as potent as those of deficit finance. Much depends upon the way in which the revenue is obtained and to whom the redemption payments are made. Also, the effects of redemption will differ widely according to the economic conditions of the period. A situation in which deficit spending may be discontinued—either because the policy was successful in the pump-priming sense or because a recovery occurred independently—need not be one which permits redemption of the debt accumulated in the preceding depression. A successful policy of balancing the budget over the cycle requires comparatively slight depression and vigorous prosperity periods.

(2) The implications of debt service are not the only concern caused by a rising public debt. The maintenance of government credit, that is of the government's ability to borrow at a comparatively reasonable cost, is of equal importance. A fall in the government's credit-standing would not only result in higher

cost of borrowing, but might also produce serious difficulties in the placement of new issues and may thus be a prelude to a more severe break in the state of public finances. The conditions of the federal bond market in the thirties with its declining rate of interest and ease of absorption of new issues was indicative of the highest credit rating. Yet, it must be recognized that the conditions for federal borrowing were exceedingly favorable, conditions which may well be subject to future change; legislation increasing the attractiveness of federal issues for bank portfolios; the growth of savings institutions favoring "gilt edged" investments; the absence of any large volume of new private issues; exceedingly low rates in the money market and a high state of liquidity preference; income tax exemptions,—all factors favorable to the government bond market.

In considering possible changes in the market for federal bonds, three cases may be distinguished:

First, there may be a decline in the demand for federal bonds due to saturation of certain institutional savers with this type of securities. That this ceiling is not an imaginary one follows from the extent to which member bank, savings bank and insurance company assets are already in the form of federal securities (compare the percentage figures quoted above) and from the comparative rate of growth of these assets. As against an average annual growth in the assets of savings banks and life insurance companies of $1.286 billion (1930–38) there occurred an average increase in the federal debt of $2.6 billion over the same period.[31] For the case of commercial banks no such absolute ceiling exists due to the acceptance of federal bonds as reserve collateral; borrowing from member banks, however, constitutes a somewhat special case to be considered below.

Second, a cyclical decline in the market for government securities may result from an increased attractiveness of other investments, as might be the case if a self-sustained prosperity movement should materialize. As the result of a shift from government to higher-income-yielding assets, the cost of debt service will be raised but government credit need not be endangered since further borrowing will be unnecessary under such conditions and increased tax revenue will be ample to finance the temporary addition to interest costs.

[31] From 1930–1938 mutual savings bank assets increased by 1.277 billion dollars and life insurance assets by 9.013 billions *T.N.E.C.*, *op. cit.* p. 4052.

Third, the market for government bonds may fall due to a declining faith in the ability or willingness of the government to meet its obligations. This, the most serious cause of a fall in government credit, should not occur unless the tax system becomes incapable of supporting the growing volume of debt service.

(3) On the assumption of a generous recovery movement, the heavy holding of government obligations in the portfolios of the member banks may cause serious difficulty. With an improving loan market and rising interest rates, the banks will begin to unload government securities, depressing the bond market further and raising the interest rate. The higher interest rate in turn may tend to arrest the upswing. While it is quite natural that the course of prosperity should be accompanied by falling bond prices and a rising rate of interest, the potential unloading of heavy security holdings by the member banks is likely to accentuate this movement and, hence, to exert a stifling effect upon recovery. In so far as the banks do not unload their government holdings, their reserve situation may be endangered by a fall in the value of their assets.

This difficulty might be avoided if the government succeeded in maintaining the bond market by open market buying. Assuming that the recovery would be sufficiently sustained to permit these purchases to be tax-financed, this procedure would also contribute towards balancing the budget over the cycle. However, debt retirement in prosperity carries with it a set of difficulties of its own. In the absence of contraverting action by the banks, debt retirement in a period of rapid expansion tends to "feed the boom" by supplying additional capital available for new investments. Thus, a policy of debt-retirement in boom-periods increases the danger that the boom will be characterized by excessive investment and be followed by recession.

The same may result from a possible conflict between the interests of the Treasury and the Reserve System in regard to monetary policy. If a shortsighted view be taken by the Treasury during the boom period, the maintenance of an easy money market and, hence, a low cost-debt service may be pressed ahead of a possible need for restricting a speculative boom by tightening of the interest rate structure. The policy of deficit finance and the growing public debt in more than one way increase the concern and influence of the Treasury in the

money and capital markets and the dependence of the banking system upon public finances. Coördination of Treasury and Reserve policies is thus essential.

(4) Apart from the effects of deficit finance upon private investment considered previously, the question must be asked—though no definite answer appears possible—whether the absorption of public securities competes with private outlets for available investment funds. Such competition is by no means impossible: Just as the mere fact of unemployment of resources does not assure that public employment will absorb previously unemployed resources only and not transfer resources from private to public employment, so the existence of excess savings in the aggregate fails to assure that the savings absorbed by the government will be drawn from the "excess" rather than from that part of the savings stream which otherwise would have found its way into private investment. The view of the volume of savings and investment as homogeneous sum totals is altogether too simple, overlooking as it does the essential qualitative differences on both sides of the problem. May not the easy availability of gilt edged (and partly tax exempt!) investments have reduced the willingness of individual and institutional savers to accept less safe gilt edged securities, and may not this tendency have affected the prices and hence the flow of new issues?

(5) A final possible implication of debt accumulation is that of inflation. To avoid popular confusion on this point different types of inflationary effects should be distinguished. The income-creating effects of deficit finance, while inflationary at the outset, are the very essence of its income-raising mechanism. It is obviously not this reaction which we have in mind when speaking about "inflationary dangers," but the possibility that an uncontrolled or violent inflation may develop.

Among the possible sources of inflation, excess reserves of the commercial banks are the most important single factor. The large volume of excess reserves in this country takes the teeth out of traditional instruments for control of credit inflation. But there is little connection between the volume of excess reserves and the policy of deficit finance. Government borrowing from non-banking sources merely causes a shift in the title to deposits, leaving the volume of reserves and deposits (and hence, the reserve ratio) unaffected. If excess reserves are

available, government borrowing from member banks will result in a slight reduction in reserve ratios,—deposits being increased while reserves remain constant. Direct Treasury borrowing from the Reserve Banks, Reserve Bank purchases of member bank (and non-bank) holdings of governments, or member bank borrowing from Reserve Banks with the governments as collateral *will* increase excess reserves, but neither of these methods has been employed to any great extent.[32]

While there is little connection between excess reserves and the policy of deficit finance, deficit spending based upon borrowing from the banks is responsible to a considerable extent for the heavy increase in the volume of deposits that occurred during the last decade. The swollen volume of deposits and their low rate of turnover must not be overlooked as a potential source of inflationary danger. An increase in velocity in response to an upswing in investment may become the more dangerous, since but poor if any means of controlling velocity are at the disposal of the authorities.

There remains the case of a policy of deliberate violent inflation designed to "save" the government from financial collapse, as in the classical example of post-war Germany. Needless to say, such a policy of repudiation by means of inflation implies fiscal chaos of the worst sort, with all its dire political and economic consequences. But such policy is an effect rather than a cause: The conditions under which it may result are those where the debt burden has become unbearable.

(6) Having discussed the various implications of deficit finance, we return to the second alternative, i.e. government spending financed by the issue of non-interest-bearing paper. To what extent will such policy avoid the difficulties discussed? What additional implications does it entail? The non-interest bearing paper may take the form of either greenbacks or non-interest bearing bonds. On many counts the paper money (greenback) technique is superior to a loan-financed program of deficit spending. It will increase the income-creating effects of deficit finance; there will be no problem of interest or debt service; the

[32] Direct Treasury borrowing from the Reserve Banks is now prohibited. During 1932 and the first half of 1933 Reserve Bank holdings of governments increased considerably (from 759 million dollars in January 1932 to 2.4 billion dollars in June 1933), but showed little variation since. Member bank holdings of government securities rose from 4 billions in June 1930 to 13.9 billions in March 1940. As percentage of total earning assets, they rose from 11.3 per cent to 42.2 per cent.

potential difficulties of placing public issues will be avoided; the elasticity of the policy will be increased. As against these advantages, certain disadvantages must be thrown into the balance. First, and most decisively, there is the stifling effect of such a policy upon business confidence which is certain to react more violently to a policy of "printing" than to more "conservative" methods of deficit finance. The elimination of certain checks and difficulties in the way of a loan-sustained policy of deficit finance, furthermore, greatly increases the danger that the policy may be abused by an irresponsible government. Finally, there is the difficulty of "mopping up" the increased volume of paper money if a policy of retrenchment should become desirable,—analogous to the problem of controlling an increased volume of deposits which result from deficit spending, financed by deposit creation. All in all, the greenback technique, while avoiding the problem of debt service, entails too many other difficulties to be regarded as a satisfactory solution.

The issuing of non-interest bearing bonds provides a compromise between the greenback and the regular borrowing policy. If the bonds find voluntary purchasers, the situation is similar to that of regular borrowing, with the important difference that there is no need for interest service. The government will still have to maintain the value of the bonds and to carry out redemption at face value. If no market for non-interest bearing bonds exists and the bonds have to be "sold" by compulsion, the policy will be one of imposing non-interest-bearing forced loans. If the situation will permit the balancing of the budget over the cycle, this policy of "advance taxation" may be worth considering; but under such conditions the objection against borrowing of the regular sort similarly disappears. If, finally, the non-interest bearing bonds are acceptable as circulating media, there is little difference between this policy and that of printing greenbacks, with the possible exception that the latter may be made acceptable as central bank reserves where the former are not.

Government ownership of the banking system, like the printing technique, may supply a solution to certain aspects of the debt dilemma. Owning the banking system, the government can create its own deposits free of charge, and thus obtain much the same effect as from the printing press. But additional com-

plications will arise due to the resulting government control over the distribution of credit. While the merits or demerits of such control cannot be considered here, it should be clear that the transfer of the banking system into public hands would be of greatest consequence.

Public spending, in order to be income-creating, need not be deficit spending. But, as a matter of practical possibility, the chances of tax financing income-creating spending are limited, particularly in times of depression. Tax sources in question, that is the higher income tax brackets, inheritance taxes and the undistributed profits tax, offer delicate problems. Those taxes which are most likely to render the revenue-expenditure process income-creating are at the same time most likely to lower the marginal efficiency of capital. This, however, does not mean that a policy of deficit spending implies an inactive tax policy. The effects of deficit spending may be achieved through the addition of loan financed outlays as well as through tax reduction and loan finance of existing expenditures. In so far as a policy of deficit finance is undertaken for the sake of its income-creating effects, the latter method is preferable to the former since it results in a temporary reduction in the tax burden and avoids an unnecessary growth of government expenditures. But otherwise the consequences of deficit finance remain the same.

In conclusion: The bulk of future income-creating public expenditures must be financed through interest bearing public issues. The results of such a policy are not threatening for some time to come; but they are bound to be disastrous at some future point, unless mitigated by a corresponding increase in taxable national income (to which there are definite limitations) or the direction of public expenditures into self-liquidating investments. Subject to the latter solution or to far reaching structural changes in our economy (e.g. the socialization of the banking system) continued deficit finance is no long-run solution to our economic problem. Again the need for supplementary policies is evident.

PUBLIC SPENDING AND THE WAR

There exists a feeling among some people that however necessary government spending may have been before August 1939, the outbreak of war in Europe provides us with so power-

ful a stimulus for expansion, quite apart from our own armament expenditures, that "artificial" support from our government is now superfluous. In its more sophisticated form, this argument is presented as the "principle of the foreign trade multiplier." It is not only investment which has the effect of raising income to a multiple of the amount spent; an export surplus will also have that effect. The new net income provided from foreign trade will be re-spent in the same manner as new income provided by net investment. The "marginal propensity to consume" will be defined in exactly the same manner as before: the proportion of new income that is re-spent. Now, however, imports are not included as a "leakage" in calculating the "marginal propensity to consume," but are subtracted from exports to determine the amount of net income that is to be multiplied in estimating the ultimate rise in national income. Indeed, the principle ought to be called the "foreign trade *multiplicand*" rather than foreign trade multiplier.[33]

Some limitations in the application of this principle will suggest themselves immediately to the reader. We cannot hope to go on indefinitely enriching ourselves at the expense of our neighbors. If our export surplus corresponds to an import surplus in other countries, then "other things being equal" income in other countries will be shrinking, and the ability of other countries to go on importing will diminish. Payment for imports from the United States out of gold *stocks* cannot continue for long; we already have over four fifths of the world's monetary gold, and our share increases daily.[34] Payment by gold *production* can continue for some time and to the extent that net imports are covered by gold production, income of foreign countries need not shrink,—not in monetary terms. Gold production is as good a source of money income as anything. How-

[33] If Y is income, I investment, C consumption as before, and E is exports and Z imports, then we can express the principle as follows:

$$\Delta Y = (\Delta I + \Delta E - \Delta Z) \cdot \frac{1}{1 - \frac{\Delta C}{\Delta Y}}$$

[34] In order to avoid misunderstanding, it should be mentioned that of the ten odd billions of gold that came into this country between 1934 and 1940, only 3 billions or so represented net exports and the balance represented flight of capital. Since the beginning of the war, restrictions on the supply of foreign exchange imposed by the belligerents have greatly reduced the proportion of gold inflow that can be accounted for by capital movements. About half of the 250 million dollars that have come in monthly since the war began were in payment of exports; the shift from a credit to a cash basis in the American export trade and leaks in the control of capital movement account for the rest.

ever, as the war progresses the opportunity costs of producing gold will mount and the difficulties of shipment will increase. It goes without saying that as full employment in this country is approached, the advantages of an export surplus tend to disappear. With "full employment," the exchange of goods for gold that we don't want or use is equivalent to giving goods away.

We are probably still some distance from "full employment," and the possibility that export surpluses may continue to exert an income-raising influence for a considerable period in the future cannot be ignored. It is worthwhile, therefore, to make an estimate of the probable effect of the war on the volume of our foreign trade.

Briefly, the story of American trade since the outbreak of war is as follows. For the first six months of the war, exports from the United States were up 35.1 per cent over the same period in 1938–39. Imports rose 28.3 per cent, so the balance improved only slightly, and was somewhat below the 1937–38 peak. As the war really got under way with the invasion of Norway,—and with the successive invasions of Denmark, Belgium and Holland, and France—exports, imports, and the export surplus all dwindled. With the termination of the French campaign, European exports increased again, as a result of large shipments to Great Britain. Exports to neutrals unable to get shipment from belligerents have increased more than our exports to countries at war. Exports of agricultural products, automobiles and parts, have actually fallen below the 1937–38 level, the big increases being in metals, machinery, airplanes and

TABLE 5
(*$ thousands*)

	Exports		*Imports*		*Surplus*	
	1939	1940	1939	1940	1939	1940
Belgium	4,393	.04	4,446	455	—153	—419
Denmark	2,048	.37	292	88	1,756	74
France	14,912	206.	5,145	1,751	9,767	182
Germany	5,331	383.	3,976	201	1,355	82
Netherlands	5,181	...	1,524	151	4,657	(—151)
Norway	1,786	3.9	1,856	87	—70	—83.1
Great Britain	33,476	108,368.	11,086	20,299	22,390	88,069
Europe	88,476	122,837.	44,160	32,302	44,316	90,535
Total	229,631	317,015.	168,910	217,827	61,721	100,188

Source: U. S. Dept. of Commerce, *Monthly Survey of Foreign Commerce*, Sept. 1940.

other military vehicles, iron and steel, and so forth. It is hard to estimate the net effect upon the American economy of such an unbalanced increase in export surplus.

In any case, it is safe to say that the net income-creating effect of the increase is not enormous. Figures for the month of July are shown in Table 5.

Thus only the large increase in exports to Great Britain prevented a decline in exports to Europe as a whole. It seems unlikely that the increase in export surplus for July 1940 over July 1939, amounting to about 38 million dollars, will be maintained. For the first eight months of the year, the change was as follows:—

TABLE 6
TOTAL TRADE
(*$ millions*)

	1939	1940	Change
Exports	1,896	2,735	839
Imports	1,437	1,746	307
Balance	457	989	532

Source: U. S. Dept. of Commerce, *Monthly Survey of Foreign Commerce*, Supplement, Sept. 1940.

For the duration of the war, an export surplus ranging between one and two billion dollars per year can be expected. During the late twenties, our export surplus averaged around 850 millions.

Thus, even if our export surplus continues as in the past few months, it will hardly begin to solve our problem. There is little chance that an estimated decline in average annual investments in equipment, plant, housing, and public utilities from 16.1 billion dollars for the period 1923–1929 to 11.4 billions for the years from 1936–1939 will be offset by an increase in export surplus.[35] The conclusion is thus clear-cut that the outbreak of war and its significance for American economic conditions by no means shoves the problem of public spending into the background. The task of raising the national income to a reasonably high level, a level compatible with our productive potentialities, is still on our hands.

A far more important result of the war than any increase in foreign trade is our own rearmament program. Spending for

[35] Basic figures from Terborgh, *Federal Reserve Bulletin*, 1940.

military defense now is expected to reach the level of 4.5 billions per year or more, thus greatly exceeding expenditures on public works. Armaments, of course, do not add directly to real income, although they may be necessary to prevent a decline in real income in the future. "Leakages" are likely to be small; newly employed workers are likely to spend their incomes almost as fully as workers on federal projects, profits are likely to be reinvested, either by corporations, or by the government through taxation and expenditure. They combine a demand for output of basic industries, such as steel, with a need for *new* plant and equipment, such as airplane factories. "Leverage" effects are therefore likely to be high. Moreover, debt incurred for national defense causes the business man less trepidation than debt for public works and is less likely to be offset by a decline in private investment.

SOME PRACTICAL PROBLEMS

Planning Public Works

The record of American governments with respect to cyclical planning of public works since the first World War has been a lamentable one. Public works have been expanded during booms when funds were plentiful, contracted in depressions when budgets were hard pressed. Employment in public construction increased from 20.5 per cent of construction employment in 1925 to 23.3 per cent in 1929—a boom period in which public construction should have been falling not only relatively but absolutely. During the downswing from 1929 to 1932, total public expenditures on public works shrank to half their 1929 level. Total construction, public and private, fell from 13 billion dollars in 1928 to 4 billion dollars in 1932; it is evident that American governments failed to introduce anything like an effective "compensatory" program in this early phase of the depression. From 1933 to 1938, employment on regular federal and PWA construction rose less than state and local construction employment fell; the tremendous rise in relief payments (FERA and work relief, that is WPA) however produced a considerable net increase in public wage (and dole) payments. In spite of the continued inverse fluctuation in state and local outlays, federal expenditures thus introduced a heavy barrage of compensatory spending. Yet, there is little doubt that a

planned shifting of regular federal public works to the depression period would have reduced the need of improvising work relief projects and would have resulted in an improved project choice. The record of cyclical public works planning from 1932 on was thus handicapped by the omissions of the previous period.

It must not be thought that the sole administrative problem of public works planning is the postponement of projects from prosperity to depression wherever possible. The public-works planner is faced with the essential economic problem of distributing scarce resources among a multiplicity of ends in such a manner as to maximize the satisfaction of the community. The spending authority will have to choose between projects which yield more service to the community and those which are likely to have greater "leverage" effects, or others which may be made self-liquidating; between a counter-cyclical volume of expenditures and the minimizing of costs on particular projects; between proper timing of expenditures and careful consideration of projects from the long-run point of view. Not only will there be conflicts between ends, but between governmental units. The federal government will be more concerned with raising the level of national income and employment, state and local governments with the immediate benefits to their own communities from the particular projects chosen. Such conflicts may lead to a middle-of-the-way course in which no ends are sacrificed altogether to the attainment of others, but it may lead to stultifying compromise in which no ends are achieved completely or effectively.

The relative importance of the various criteria, furthermore, varies with the type of spending theory that is held. If we spend purely for relief, the amount of employment created directly by a given amount of expenditure will be the sole criterion. Even here decisions are difficult enough; for projects of the WPA type, which provide a large amount of on site employment per dollar spent, may create considerably less employment in the material supplying industries than projects of the PWA type which provide less on site employment per dollar. If we regard spending merely as a factor offsetting fluctuations in private employment, disregarding "leverage" effects, it is clear that, in the absence of other stimulating forces, the volume of public works in the midst of depression must

be very much larger than anything experienced to date. Government employment during the thirties at no time amounted to one third of the volume of unemployment. If spending on a scale large enough to absorb all the unemployed is to be considered, the criterion of utility becomes highly important. Yet, it is also important to have flexibility; public works must be started as soon as unemployment appears, must be reduced as soon as private demand for labor revives. Unfortunately, these ends may well be incompatible.

If one regards "secular stagnation" as the chief cause of the unemployment which is to be reduced by public works, the planning problem is relatively simple. No timing questions arise; we look forward to a more or less steady increase in the volume of public works. Direct utility will be of prime importance, but maximization of multiplier effects and minimization of adverse long-run effects on private investment must also be considered. In this case, the following criteria would be of major importance: The project should supply useful, if possible essential, public services of a sort which can not profitably be supplied by private enterprise without permitting a high degree of monopoly; the project should, furthermore, require heavy investments and contribute to its maintenance—that is, be wholly or in part self-liquidating. Transportation, low-cost housing and, possibly, the public utility industries fall into this group. To the extent that the secular stagnation argument holds, it seems advisable for the government to go directly into such fields as these.

If we are basing our hopes for recovery entirely on the "multiplier," flexibility is again of no importance. We would expect to go on spending forever, probably at an increasing rate. Immediate utility of the projects and relative effects on the rate of re-spending (minimization of leakages) will be the most relevant criteria.

If we rely on the "relation" as well, we will again choose projects which put money into the hands of those who will in general spend a large proportion of it, but we will also aim at its being spent particularly in those fields where an increase in consumption will have the biggest effect on investment, whether because of high capital intensity in production, low excess capacity or because sales in that field are regarded as an index to trends in general business conditions. Flexibility will be

important, since we will want to start spending before capacity falls too low for it to be effective and we will want to stop spending as soon as full employment is reached.

Under a pure pump priming theory, the problem of timing is complex but all-important. There will be no need to start projects in a hurry once the boom breaks, since the stimulating effects of the policy are certain to be greater after some deflationary movement and resulting adjustments have taken place. One should, however, not assume that the deflationary movement must in itself produce a bottom from which an upward movement is bound to start. The deflationary process may in itself call forth new maladjustments, once it has passed a certain point; the problem of timing is thus one of choosing the right moment for the injection of public expenditures. A similar delicate problem arises in regard to the time and rate at which public expenditures should be withdrawn, once the pump has been primed.[36] The choice of projects is entirely dependent upon this need for flexibility: They must be quickly launched and must either be short lived or permit rapid discontinuation. Above all, their introduction and withdrawal must be handled with great resoluteness and discression.

If we are more realistic and consider the whole "leverage" effects, including multiplier and relation as well as induced investment and consumption, we would concentrate on projects having large "multiplier" and inducement effects but small "relation" effects, since it is this sort of program that offers most hope for stability at a high level of income. We must taper off expenditures as induced investment increases, so we must have *some* projects that are flexible. We want to put a cushion under the deflation and must have some projects that can be quickly launched; we do not want to support an inflationary boom and must have some projects of short duration.

It is clear that if spending is to start immediately when a crisis emerges, there must be a ready store of projects on hand

[36] A heavy and abrupt decline in the flow of "income-creating" government expenditures is bound to be harmful,—witness the experience of 1937 when "income-creating" expenditures of the federal government declined from 4.3 billion dollars (1936) to 1.1 billion (1937). (Lauchlin Currie, T.N.E.C. *op. cit.* p. 4011.) The coincidence of the decline in "income-creating" public expenditures and in national income suggests some causal relationship. The argument, however, that this incidence proves the effectiveness of the deficit policy in the thirties has little merit. It in no way shows what the national income would have been in '37 or '38 had there been no large scale deficit finance in the previous period.

to be launched, with funds appropriated, contracts awarded, and private entrepreneurs ready to start work at a moment's notice. Not only must government appropriate funds which may be spent by its successor but it must delegate the decision to start spending to an administrative board. There seems little hope of achieving this state of affairs in a democratic organization.

At the beginning of this section we mentioned the possibility of conflict between federal, state and local administrations with respect to the choice of projects. In order to minimize such conflict some means of joint action must be provided, since overlapping and waste is bound to result in the absence of coördination of planning by the various levels of government. The method of allocating cost, with special consideration of the limited revenue-raising power of the state and local governments, presents knotty problems. Moreover, many projects do not fall properly within the jurisdiction of any existing administrative units. There is a crying need for regional planning authorities, a need which is only gradually being met.

Public policy takes concrete form in the hands of the administrator; its effects depend upon the form in which it is carried out rather than upon the form in which it was originally devised. Administrative infeasability can thus be a decisive objection to a policy, no matter how sound on other grounds. But it must be recognized also that the bugbear of "administrative difficulty" provides a ready apology for economic inaction, even where administrative difficulties can well be overcome. There is ample room for feasable improvements in the administrative aspects of planning, organizing, and executing public works. The extent to which an administrative mechanism can be devised which will permit transformation of deficit spending into a refined tool of business cycle policy—similar to that of central banking policy—is a serious question. There is much doubt whether this objective can be achieved without a central control agency, similar to the Federal Reserve Board. The disadvantages of such concentration of spending control are obvious from the point of view of democratic control over public finances,—but so is the conflict between precise and acute government action in the economic sphere and a decentralised and slow moving political machinery.

Budgetary Technique

An adequate budgetary technique, while no substitute for sound fiscal policies, facilitates their achievement. In order to contribute to an efficient planning, administration and congressional discussion of the fiscal program, the budget must be constructed to give a clear picture of the relevant factors involved in the proposed policies. It is thus obvious that the form of the budget should be affected by its content. In view of the great increase in the volume of federal loan-financed outlays for relief and public works the question arises whether this development does not call for some adjustment in the structure of the budget. The discussion is greatly complicated by the variety of balance concepts which may be considered relevant and the variety of corresponding budgetary techniques which may appear desirable. Certain balance-concepts, while highly important, are too complex to permit expression in terms of ordinary budgetary technique.[37] The state of "monetary" (or income) balance, indicating whether the revenue-expenditure process is net-income-creating, neutral, or income reducing, is a good example. Here, we are only concerned with those balance concepts which are of major importance from the point of view of budgetary technique.

(1) The traditional "liability-balance" concept is concerned with changes in the outstanding volume of government obligations. Its significance derives from the simple fact that debt accumulation in itself raises important problems. Allowance must be made, therefore, for the dependence of the debt problem upon the way in which the loan sum has been spent. While one must be on guard against an abuse of this argument,[38] it is applicable where the borrowing is accompanied by expenditures which in themselves will meet the difficulties of increased debt accumulation. Regarding the previously discussed problems of debt service this condition is met in the case of self-liquidating

[37] For a more detailed discussion cf. Musgrave, R. A., "Budgetary Balance and the Nature of the Capital Budget." *American Economic Review*, June 1939.

[38] The mere "necessity" for deficit finance as in war time does not affect the future consequences of debt accumulation. The time-honored practice of simulating budgetary balance by means of balancing the ordinary budget and shifting loan-financed expenditures to the extraordinary budget, thus misrepresents the state of liability balance. The practice of separating ordinary and extraordinary budgets furthermore encourages an undue expansion of items in the extraordinary budget as against, and possibly at the cost of, more important items in the ordinary budget.

investments, i.e. investments yielding a fee-price return sufficient to finance the additional debt service, including interest as well as depreciation. New borrowing, if accompanied by such investments, should therefore be excluded from the determination of liability balance.[39]

This exclusion may conveniently be accomplished by placing outlays for self-liquidating investments and the corresponding loan revenues into a separate "capital budget." Illustration I pictures a case of budgetary balance, where new borrowing for purposes other than self-liquidating investments just equals debt amortization:

ILLUSTRATION I

ORDINARY BUDGET

Revenues		Expenditures	
Taxes	(a)	Ordinary, incl. interest	(d)
Loans	(b)	Relief and n.s.i.	(e)
Income from s.i.	(c)	Depreciation of s.i.	(f)
		Debt redemption	(g)
	a + b + c equals		d + e + f + g

where b — g = 0

In this and the following illustrations s.i. stands for self-liquidating investments; n.s.i. for non-self-liquidating investments.

CAPITAL BUDGET

Revenues		Expenditures	
Loans	(h) equals s.i.		(i)

A state of underbalance (deficit) would prevail if (b) were to exceed (g), while an excess of (g) over (b) would indicate a state of overbalance. Income derived from self-liquidating investments and their depreciation cost are to be included in the ordinary budget, since an excess of the costs over the income will, if loan-financed, give rise to an underbalance.

The argument for the exclusion of loan-financed self-liquidating investments from the determination of liability balance does not apply to other categories of outlays on durable goods, whether producers' or consumers' goods. While these public goods may be useful as well as productive, they are not likely to increase taxable national income by an amount sufficient to maintain a constant level of tax "pressure." Taxable capacity is a matter of monetary rather than "enjoyment" income, and

[39] We note that special position of self-liquidating investments refers to the debt service-aspect of the debt problem only. Implicit in the above correction of the traditional balance concept is therefore the somewhat doubtful contention that the debt service problem is the only significant aspect of the debt issue.

tax pressure (assuming a given tax system) depends upon the geometric rather than the arithmetic relationship between tax volume and taxable income. A dollar increase in tax collection accompanied by a dollar increase in taxable income will result in increased tax pressure; an increase in taxable income which will maintain the ratio of taxable income to taxes collected will keep the tax pressure constant.[40] The increase in money income which may accompany an increased supply of loan-financed public consumers' goods without resulting in rising prices can hardly exceed the amount absorbed in the additional debt service; tax pressure is therefore certain to rise in this case.[41]

If the loan revenue is directed into the construction of public producers' goods the possible increase in monetary income *may* be greater, depending upon the productivity-increasing effects of these investments; the extent to which tax pressure will increase is therefore uncertain.[42] However, in view of the intangible nature of these effects, all non-self-liquidating investments (whether consumers' or producers' goods) should be included in the ordinary budget in order to secure an effective measure of liability balance. Non-self-liquidating investments may be considered public "assets" in the sense of their representing valuable community property,—but they do not constitute assets in the sense of money income-yielding and self-supporting properties, analogous to the asset on the corporate balance sheet. The corporate and the public asset are similar in that they represent the value into which borrowed funds have been transformed; but they are dissimilar so far as yield is concerned. The corporate asset (that is the capital good purchased with the loan funds) will yield, under normal conditions, sufficient income to carry depreciation and debt service. If for

[40] This statement is to be considered as a first approximation only. It rests upon the contention that an essential distinction exists between compulsory taxes and voluntary prices. The former constitute extraneous interventions into the price mechanism and give rise to effects which are absent in case of the latter. For elaboration of this point cf. Musgrave, R. A., "The Voluntary Exchange Theory of Public Economy," *Quarterly Journal of Economics*, February 1939.

[41] Here we assume an equal circuit-velocity of the tax-interest payment process and the money flow in the market economy.

[42] It is, of course, possible that the indirect effects of outlays on non-self-liquidating investments upon income and employment (through the operation of the "leverage" mechanism) will result in a reduced ratio of income to taxes and, hence, in a reduced tax pressure. But so may outlays on current or relief expenditures. As far as the problem of budgeting is concerned, these effects must thus be excluded from consideration.

some period corporate assets are carried at their cost value rather than at the capitalization of their earning power, this relationship is broken temporarily; but no corporation can remain solvent if for any length of time its interest and replacement charges greatly exceed its earning power. A non-self-liquidating public property, on the other hand, may render useful services which are worth the direct cost of interest and depreciation charges. But these charges must be financed out of taxes whose effects upon the operation of the economy at large stand in no direct relation to and are not offset by the benefits received. The argument again rests upon the previously mentioned distinction between the effects of compulsory tax and voluntary price payments.

(2) We now turn to a further concept of budgetary balance developed by Swedish economists.[43] "Balance" in this case refers to the maintenance of the "public net worth" a concept which in turn may be interpreted in different ways.

A first definition of "net worth" is concerned with the relative values of outstanding obligations and of self-liquidating investments. If the "net worth" is increased (through reduction in outstanding debt obligations and/or through the creation of additional self-liquidating properties without further borrowing) the budget is "overbalanced"; if the "net worth" is decreased (through increase in outstanding obligations without corresponding increase in self-liquidating properties and/or through depreciation of self-liquidating properties without corresponding reduction in outstanding obligations) the budget is "underbalanced." An increase in the public debt for purposes other than additional self-liquidating investment is, therefore, compatible with balance to the extent that it is accompanied by a tax-financed increase in self-liquidating property.

Some changes in the budgetary technique presented in Illustration I are necessary if the state of balance in the ordinary budget is to conform to this latter interpretation of the balance concept. As far as the crux of the previous method is concerned, i.e. the distinction between liquidating and non-self-liquidating investments, the two methods are the same. Overbalance due to tax-financing of self-liquidating investments appears on the

[43] For the following discussion compare E. Lindahl, *Studies in the Theory of Money and Capital* (New York: Farrar and Rhinehart, 1939). Appendix. Lindahl's technique of presentation is applied, but a clearer formulation of the issue is attempted.

expenditure side of the ordinary budget as transfer to the capital budget. Underbalance due to loan finance of outlays for purposes other than self-liquidating investments appears as transfer from capital budget on the revenue side of the ordinary budget. All loan revenue is concentrated on the revenue side of the capital budget, which also includes a possible surplus item in the form of transfer from the ordinary budget. The expenditure side of the capital budget includes outlays on self-liquidating investments and the deficit item of transfer to the ordinary budget. Illustration IIa provides a picture of overbalance, due to tax-financing of self-liquidating investments.

ILLUSTRATION IIa

ORDINARY BUDGET

Revenues		Expenditures	
Taxes	(a)	Regular, incl. interest	(c)
Income from s.i.	(b)	Depreciation of s.i.	(d)
		Relief and n.s.i.	(e)
		Debt amortization	(f)
		Transfer to Capital Budget	(g)
	a + b equals		(c + d + e) + (f + g)

CAPITAL BUDGET

Loans	(h)	S.i.	(i)
From Current Budget	(g)		
	h + g equals		i

The budget is overbalanced to the extent of (f + g), subject to the condition that the item (d) makes full allowance for depreciation.

Illustration IIb gives a picture of underbalance, due to loan finance of outlays for purposes other than self-liquidating investments.

ILLUSTRATION IIb

ORDINARY BUDGET

Revenues		Expenditures	
Taxes	(a)	Regular, incl. interest	(d)
Income from s.i.	(b)	Depreciation of s.i.	(e)
From Capital Budget	(c)	Relief and n.s.i.	(f)
	a + b + c equals		d + e + f

CAPITAL BUDGET

Loans	(g)	S.i.	(h)
		To current budget	(c)
	g equals		h + c

The budget is underbalanced to the extent of item (c), subject to the condition that item (d) makes a full depreciation allowance.

This technique offers certain advantages over the one presented in Illustration I. First, it permits concentration of the entire loan revenue in one part of the budget, i.e. in the capital budget. Secondly, the system has been held to provide an automatic mechanism for a policy of balancing the budget over the cycle. However, this supposed merit is dubious since a periodic repayment of transfers from the capital to the ordinary budget is little more automatic than a policy of periodic debt redemption. Whether or not the budget is balanced over the cycle is a matter of policy rather than of budgetary technique. Third, and this is its major advantage, the method permits a surplus in the form of self-liquidating investment outlays financed out of taxes to enter into the determination of balance in the ordinary budget. If, as in Illustration IIa part of the surplus is due to a tax-financed increase of such investments, the tax revenue in question appears on the expenditure side of the ordinary budget as a transfer item and hence enters into the determination of balance.

While the presently considered technique secures the indication of surplus due to tax-financed investments in self-liquidating projects, it does not permit the registration of underbalance due to insufficient depreciation allowances.[44] Instead, it is assumed that a sufficient allowance is made. The same criticism holds for the technique considered in section (3), but is met by the technique considered in section (4).

From the point of view of the technique presented in Illustration I, no objections arise against the method presented in Illustrations II a and b. The inclusion of tax-financed self-liquidating investments as a surplus-element (and correspondingly, the inclusion of a reduction in such investments as a deficit element) is quite compatible with the concept of liability balance. Most important, where liability deficit prevails according to the former technique a similar deficit prevails according to the presently considered method, subject only to

[44] If the stated definition of net worth is carried to its logical conclusion, expenses as well as cash expenditures and revenues as well as cash receipts must be considered. Cf. below, section (4).

its being offset or increased by changes in the volume of self-liquidating investments.

(3) A second definition of "net worth" is concerned with the relative values of outstanding obligations and all public investments, whether self-liquidating or not. According to this interpretation overbalance (or an increase in net worth) may, in addition to the causes discussed under (2), arise from a tax-financed increase in non-self-liquidating investments; underbalance (or a decrease in net worth) may arise in addition to the causes discussed under (2) from a reduction in the value of non-self-liquidating investments without a corresponding reduction in the debt. Notwithstanding, this widening of the concept of net worth, a debt-financed increase in non-self-liquidating investments will still give rise to underbalance, while a debt-financed increase in self-liquidating investments will still be compatible with balance.

This amended concept of balance requires some further changes in budgetary technique. All investment outlays (whether self-liquidating or not) are now entered on the expenditure side of the capital budget. However, outlays on non-self-liquidating investments (not those on self-liquidating investments!) are also entered on the expenditure side of the ordinary budget, appearing as transfer to the capital budget. This transfer in turn, together with all loan revenue, again appears on the revenue side of the capital budget. If the outlays on non-self-liquidating investments are loan-financed, they will be carried twice on the expenditure side of the capital budget,—once as investment outlays and once as transfers to the ordinary budget. As far as the balance of the capital budget is concerned, this double counting is offset by the entering of loan revenue as well as transfer from the ordinary budget on the revenue side. The capital budget is always in formal balance. The advantage of this somewhat complicated procedure rests with the result that a tax-financed increase in non-self-liquidating (as well as in self-liquidating) investments will appear as a surplus (transfer) item on the expenditure side of the ordinary budget and thus enter into the determination of balance.

According to this technique, an overbalanced budget will look as follows:

ILLUSTRATION IIIa

ORDINARY BUDGET

Revenues		Expenditures	
Taxes	(a)	Regular, incl. interest	(c)
Income from s.i.	(b)	Depreciation of s.i. and of n.s.i.	(d)
		Debt amortization	(e)
		Transfer to Capital Budget	(f)
	a + b equals		(c + d) + (e + f)

CAPITAL BUDGET

Loans	(g)	S.i.	(i)
From Ordinary Budget	(f)	N.s.i.	(f)
	g + f equals		f + i

The budget is overbalanced to the extent of (e) (amortization) and (f) (tax-financed increase in investment). The assumption is again implicit that item (d) provides a sufficient depreciation allowance. Illustration IIIb offers a picture of underbalance:

ILLUSTRATION IIIb

ORDINARY BUDGET

Revenues		Expenditures	
Taxes	(a)	Regular, incl. interest and amortization	(d)
Income from s.i.	(b)	Depreciation of s.i. and n.s.i.	(e)
From Capital Budget	(c)	Transfer to Capital Budget	(c)
	(a + b) + c equals		d + e + c

CAPITAL BUDGET

Loans	(g) = (i + c)	S.i.	(i)
From Ordinary Budget	(c)	N.s.i.	(c)
		Transfer to Ordinary Budget	(c)
	g + c equals		i + c + c

The budget is underbalanced to the extent of (c) (loan-financed non-self-liquidating investments). The previous assumption regarding depreciation allowance again holds.

From the point of view of liability balance, the technique expressed in Illustrations IIIa and b raises no objections in so far as the loan finance of additional non-self-liquidating investments still appears as a deficit. On the other hand, the offsetting of such a deficit through additional non-self-liquidating investments financed out of tax revenue is not compatible with the concept of liability balance. Moreover, the complication introduced through double counting in the capital budget speaks against the method presented in illustration III.

(4) Finally, the concept of net worth may be amended so as to

treat self-liquidating and non-self-liquidating investments as identical and include both in the capital budget only. In this case, the nature of budgetary balance as applied to the ordinary budget is radically changed. If balance or maintenance of net worth is defined as a condition in which the residual of all public investment values minus outstanding obligations is kept constant, all "current" costs of government (including interest service on and maintenance of old investments) are included in the ordinary or current budget, while all outlays for the provision of future services (investments) are included in the capital budget.[45] Loan finance of all investment outlays then becomes compatible with balance, while loan-finance of current costs produces a deficit. Tax-finance of future services (investments) will appear as transfer from the current to the capital budget and thus give rise to surplus. Reductions in the value of old investments (due either to obsolescence or non-maintenance) are a current cost and have to be accounted for on the expense side of the current budget; increases in the value of old investments are registered as revenues in the current budget.

The prime advantage of a budgetary technique of this sort rests with its comprehensive statement of current cost of government (including all costs, whether or not represented in the form of cash outflow), the implied requirement for careful capital accounting, and with the statement of changes in the value of public properties which it entails. However, the definition of net worth as the residual of the value of public properties minus the value of outstanding obligations appears less significant for the public than for the corporate accounting system. It is rather doubtful whether the time-distribution of public obligations and benefits should be chosen as the focus-point of budgetary presentation.[46] Efficient capital accounting

[45] We are indebted to Mr. E. C. Brown of Harvard University for a clear statement of this approach to the capital budget problem.

[46] Maintenance of public net worth as here defined means that the future will not be burdened with additional debt obligations without receiving the benefit of a "free" flow of services due to present investment in durable public goods. The philosophy behind this balance concept thus refers to the distribution of economic welfare as between different time periods. Additional borrowing and investment in the present will result in future benefits which will be worth the future burden. Such consideration is not likely to include the effects of debt accumulation and resulting taxation upon the operation of the economy, i.e. the problem of liability balance.

In the case of a corporation an increase in its obligations and a corresponding increase in its earning assets will leave net worth unchanged; the additional earning power will provide a full offset to the additional obligations. In the case of public

in public and particularly in departmental budgeting does not require a formal capital budget. Nevertheless, an attempt may well be made to present a budget statement of this type, along with a statement of the kind presented in Illustrations I or II. If feasible, an annual balance sheet of public properties would be highly useful.[47]

Self-Liquidating Projects

From our discussion of the consequences of debt accumulation, it appeared that one solution to the difficulty rests with the choice of self-liquidating projects. The availability of such projects is thus a matter of great importance for an appraisal of an extended policy of deficit finance. In selecting investments of this sort several difficulties arise.

Firstly, there is the probability that the higher the qualification of an investment project from the point of view of self-liquidation, the greater will be the possibility that public investment may interfere with private investment outlays. Price yielding investments, open to public but not to private enterprise, do not abound: toll roads or bridges may be multiplied, but only within limits. Then there is a further group of investment outlets—low cost housing, public utilities, railroads, and the like—which, while not beyond the reach of private investment, are neglected by the latter. A policy of public investment in such fields must be aware of the danger of even further discouraging private investment. Now, it appears that this dilemma may be solved by the development of certain sectors of industry as "spheres of public enterprise", rather than by public competition with private enterprise under conditions mostly favorable to the former.[48] If deficit finance, based on the issuing of interest-bearing bonds is to become a normal feature of our economic system, the construction of such spheres of public enterprise appears inevitable, unless the policy of debt accumulation be permitted to lead to a rather disastrous ending.

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investment in non self-liquidating property, direct benefits may offset direct losses but the problem of taxation and debt effects remains. Otherwise, different types of investment would surely have to be treated differently.

[47] Numerous difficulties, in particular those of evaluating non-self-liquidating public investments, arise in this connection.

[48] The advantages of the public enterprise may be manifold. Lower interest rates, less taxes, favorable allocation of joint costs illustrate such possibilities. For a discussion of this matter with reference to the T.V.A., cf. Edward Mason, "Power Aspects of the T.V.A.," *Quarterly Journal of Economics*, May, 1936.

A second, though less important, difficulty results from the circumstance that the existence of effective purchasing power is an essential prerequisite for the operation of self-liquidating projects. Self-liquidating projects are not apt to be projects which supply needed social services to underprivileged groups; the greater the portion of public investment funds which flow into such projects, the more difficult will it be to fit the borrowing-investment program into the framework of a policy which otherwise might aim at some degree of income equalization.[49] But at the same time, the choice of self-liquidating projects will free tax revenue, otherwise assigned to debt service, for purposes of social outlays.

In regard to the requirement of flexibility in public work programs, self-liquidating projects need not be at a disadvantage. While the initial construction of plant and equipment entails a long and inflexible project, subsequent variations in the prime costs of established industries supply a highly flexible element. This will be particularly true if, by means of temporary subsidies, self-maintenance is made a cyclical rather than a current requirement. Notwithstanding, difficulties which may be encountered, much effort should be exerted towards the development of income-earning public enterprises. Such development would present a solution compatible with the nature of the market economy and at the same time would call for greatest efficiency in the public utilization of resources.

CONCLUSIONS AND ALTERNATIVES

The record of large scale deficit finance during the thirties must be explained as a short term solution to the imminent task of rehabilitating business and of financing relief, rather than as a conscious development of a new technique of business cycle policy. The birth of fiscal policy was incidental to the task of relief finance. An increasingly popular explanation of the low level of income and employment during the thirties starts from the thesis that a matured economy had come to be confronted with a severe maladjustment of the propensity to consume and investment outlets. This thesis gave sanction to

[49] The possibilities of public monopoly pricing and public price discrimination are worth exploring. As for monopoly pricing, the gains from the policy would have to be weighed against the alternative revenues from sales taxes. Public price discrimination would resemble the imposition of a progressive spending tax, already existent in the broader framework of a progressive income tax.

a policy of deficit finance quite apart from its primary objective of supporting a growing relief obligation. A consideration of this thesis was therefore necessary.

Two conclusions were reached. From an analytical point of view it appears that a secular decline in the progress and growth of our economy will indeed throw new hurdles into the path towards a full employment of our resources. On the empirical side a definite stand is more difficult. While many of the characteristics of economic maturity did prevail during the thirties, no empirical proof of the stagnation hypothesis is possible. Other factors may have been of equal importance in that period. In as much as the saving-investment analysis does present the key to our economic problem, there is the further question of how closely the future course of events may be deduced from present tendencies.

But whatever the relative importance of cyclical fluctuation, long wave and secular stagnation in explaining the low level of employment and national income in the 1930's the situation was clearly one that called for action. While conditions have improved somewhat since the outbreak of war, the need for economic policy designed to produce the full-employment level of income has not disappeared. Expenditure on armaments will no doubt have a stimulating effect, but does not provide a permanent solution. A time will surely arise when it will be wise to devote more resources to raising the national income directly and less to national defense. The usefulness of deficit finance as a means of combatting under-employment is not restricted to the case of a matured nor stagnating economy; it applies to the case of long wave and cyclical depressions as well and is therefore certain to remain in the forefront of economic policies.

We have argued that on the whole, deficit-financed public expenditures do constitute one means of combatting under-employment. On the other hand, we have shown that the analytical evidence that deficit finance will achieve its purpose is not entirely clear-cut, particularly when possible unfavorable reactions of business men are taken into account. In any real case, much depends upon the manner in which the spending program is conducted. A more complete statement of the ends and means of public spending, and unwavering adherence to the program set forth, plus more regard for the just fears of business

men, would do much to make a policy of deficit-financed public expenditures effective in raising national income. The program undertaken by the Roosevelt administration could have been carried out with considerably greater support from business and, therefore, with much more favorable results, had it not been launched in an atmosphere of hostility (verbal and real) to big business in general.

We have also pointed out that the problem of successful deficit financing is by no means limited to producing the conditions under which the spending will lead to a rise in national income. It behooves the spending authority to recognize the need for maintaining that higher level of income once achieved, and to be prepared to take whatever steps are necessary to maintain it. In view of the tremendous difficulty in predicting the reaction to public spending, the task of controlling the upswing so as to prevent a relapse or a run-away inflation is extremely difficult. Administrative problems also arise, calling for planning bodies with federal, regional, state and local jurisdiction, and with wide powers to assure prompt and decisive action. Budgetary reform seems also to be called for, in order that the planning bodies, the spending authorities, the Congress and the general public shall have a clearer picture of the state of government finances. We have demonstrated that the problem of the debt itself, while not a pressing one at the present time, must eventually be faced.

In so far as deficit financed public expenditures continue to be the mainstay of government policy for attaining and maintaining a high level of employment and income, our investigation suggests that as large a proportion as possible of public spending should be in the field of self-liquidating public works. Indeed, this form of expenditure seems to be the only one that can be continued indefinitely. On the whole it seems better for the government to take over certain fields of enterprise altogether than to compete with private enterprise. Certain types of industry, where there is an inherent tendency to monopoly and where the public interest is clearly at stake, seem best for such government ownership. Railways and public utilities come immediately to mind. Toll roads are another possibility; experience in recent years suggests that the inconvenience usually stressed in arguments against toll roads has been much exaggerated. Some public recreation facilities might

similarly be on a self-liquidating basis. Also, public spending programs should be planned to provide a certain volume of permanent expenditures, a certain volume that can be begun and finished in a period of a few years, and some that can be begun in a few weeks and finished in a few months.

As examples of complementary policies, which must accompany deficit financing if it is to be ultimately successful, we might mention control of the "propensity to consume" through taxation and monetary policy. We have seen that too great a decrease in the marginal propensity to consume, as the upswing progresses, may make necessary a continually increasing rate of public expenditure, thus adding to the debt problem. At such times, redistribution of income in favor of the lower groups, to maintain the marginal propensity to consume, seems to be called for. Such a redistribution might be achieved by a rise in income and inheritance taxes and reduction of commodity taxes. On the other hand, too great an increase in consumption in the stage of recovery where the acceleration principle operates may lead to over-investment. In this stage, accordingly, either consumption itself should be restricted, which may stop the recovery short of full-employment, or the amount of investment resulting from a rise in consumption should be controlled. Here is one place where monetary policy might enter; investment could be restricted by a rise in interest rates, preferably a qualitative rise, in this stage of recovery. Obviously, interest rates should be as low as possible in the early stages of recovery, but should rise as excess capacity disappears. Similarly, if a policy of debt reduction is embarked upon during the later stages of the upswing, the monetary authorities should institute restrictive measures, such as a rise in rediscount rates, or raising of reserve requirements, to prevent the debt reduction from having an inflationary effect. In order to maximize the leverage coefficient in the first phases of the upswing, spending should be directed so as to render price relationships more, and not less, inducive to private expansion. In the later phases care should be taken to avoid a premature relapse due to the formation of bottle necks. Coordination with an active price policy may greatly increase the leverage effects of a given volume of deficit spending.

Techniques of economic policy, like economic theories, have their fashions and there is some danger that deficit finance

should be considered a cure-all, similar perhaps to central banking policy in the twenties. We do not want to leave the reader with such an impression. The theoretical and practical difficulties which bestrew the path to successful deficit financing are serious enough to warrant the most careful attention to supplementary policies which are available. Some supplementary policies might profitably be mentioned. A tax on the holding of idle cash balances, including bank deposits, if properly administered, would offer a weapon for control of the velocity of circulation, the lack of which has been one of the most severe gaps in the arsenal of banking policy. A thawing out of price rigidities, particularly in the factor of production market, may facilitate expansion and secure a more orderly upswing. Some government supervised means of providing for concerted business action, such as the NRA originally envisaged, may decrease the risk of individual expansion and thus induce business to go ahead on its own; by means of a supervised sharing of market information, less wasteful but equally effective competition may be made possible. Greater emphasis on the qualitative aspects of government spending, including a possible development of government lending and subsidy schemes, may increase the effectiveness of a spending policy, deficit or otherwise. Public sharing in the risk of developing new enterprises may offer a way to increase the volume of "acceptable" investment outlets. A revision of tax policies in the direction of rewarding rather than penalizing risky investments,—all these are policies the analysis of which would require essays of their own. Dedication of the present study to the problems of deficit finance alone does not suggest our views regarding the potential merits of supplementary policies.

FOREIGN TRADE POLICY IN THE BUSINESS CYCLE

William A. Salant

SUMMARY

FOREIGN *trade may affect the national income. Changes in exports or shifts in demand between imported and domestic goods may initiate movements in income. The multiplier associated with the determinants of income in part results from the marginal propensity to import.*

In a program designed to combat depression, foreign trade policy can be either alternative or complementary to domestic action. It is alternative when it raises income by stimulating exports and restricting imports, without at the same time expanding private or governmental expenditure. It is complementary when it maximizes the effect of domestic expansion on home incomes by preventing higher imports.

Restriction of foreign trade is a natural accompaniment of depression. It is invoked both to mitigate balance of payments difficulties and to maintain or restore home incomes.

The freedom of different countries to expand or contract independently of the rest of the world differs widely. Within broad limits the United States has monetary autonomy. Other countries can carry through policies of domestic expansion provided they supplement them with strong measures to defend the balance of payments, while still others have almost no monetary freedom.

Home investment is a far more important determinant of income in the United States than international factors: it is larger and is subject to wider fluctuations. Furthermore, since the marginal propensity to import is comparatively low, the effect of these fluctuations falls primarily on home incomes. Because home investment has fluctuated violently in recent years, the American economy would have been more stable with a higher propensity to import and a higher volume of exports. Whether this will continue to be the case in the future depends on the economic organization of the post-war world.

Even though the marginal propensity to import is low, the level of activity in the United States exerts a strong influence on the rest of the world because of the size of the United States and the violence of fluctuations here. Depression in the United States makes for trade restrictions abroad; recovery here would be a powerful influence against them.

THE EDITORS

When resources are fully employed, the economic problem is to use them as efficiently as possible. When they are only partially employed, it is to raise the quantity of employment as well as to maximize its efficiency. Because of this difference in the nature of the problems, policies that are appropriate under conditions of full employment may be inapplicable when resources are unemployed.

Much reasoning about foreign trade policy, based as it is on the assumption of full employment, becomes fallacious when misapplied to conditions of unemployment. This essay is a discussion of the relation of international trade to domestic prosperity under conditions of partial and fluctuating employment. The first section contains an outline of the analytical framework which underlies the remainder of the paper, the second a discussion of the part played by foreign trade in the transmission of cyclical fluctuations between countries, and a statement of the issues of policy that arise. The final section is an examination, with respect to these issues, of several countries and, in particular, of the United States.[1]

EXPORTS, IMPORTS AND NATIONAL INCOME

The national income of a country can be defined as the net value of goods and services produced, including those sold to foreigners as well as those marketed at home. If the value of the product destined for the domestic market remains unchanged, a rise in exports[2] will involve an equal rise in the national income. But the increase in exports will itself influence domestic consumption. Exporters and all those who assist in production for export will find that their incomes have increased. They will spend either all or a part of the increment on home-produced consumption goods, thereby raising the in-

[1] I have profited greatly from discussions with Professor Alvin Hansen and Mr Emile Despres.

[2] Throughout this paper I have used the terms "exports" and "imports" to refer respectively to total receipts and payments on current international account, including the exchange of services and interest and dividend payments as well as merchandise trade, except where statistics are used. The more inclusive and accurate terms are too cumbersome, and any possible misunderstanding could do damage, since any statement made about "exports" or "imports" in the paper applies equally to merchandise transactions or to all current receipts or payments. It is true that some of the service items in the balance of payments may be relatively fixed or may vary for special reasons, but the same might be said of many types of exports and imports. Furthermore, merchandise trade usually constitutes the bulk of the international income account. Hence the gain in convenience far outweighs the disadvantage of the looseness in terminology.

comes of producers of those goods. These producers will in turn increase their expenditures. The question arises, how far will the increase in incomes go?

Saving and Investment Excluded

To arrive at an answer which will suffice for the needs of this paper, it will be convenient to assume at first that in the country in question neither saving nor investment,[3] positive or negative, takes place. All goods and services produced are either immediately consumed at home or sold abroad; all income is spent either on imported or on home-produced consumer's goods. Under these conditions exports must equal imports, for an excess of exports could be financed only by foreign lending or the purchase of gold from abroad, either of which requires saving, while an import surplus would involve foreign borrowing or the sale of gold, and negative saving.[4] Furthermore, we will assume that when a person's income and consumption rise, he increases his purchases both of imported and of home-produced goods.

In such a country, a rise in exports will increase both income and imports, and the rise in income will stop at the point where imports are equal to the new level of exports. If only a small part of the additional income is spent on imports, the rise in income will be large, but if most of it is spent on imports, the rise will not be much greater than the original increase in exports. If we call that fraction of a small increment in income which is spent on imports the marginal propensity to import, and its reciprocal the multiplier, the increase in income consequent on a small increase in exports will be equal to the product of the rise in exports and the multiplier.

The fraction of total income sent on imports at any level of income is the average propensity to import, and the whole schedule of related values of income and imports is the propensity to import function. The level of income can be altered by changes either in exports or in the average propensity to im-

[3] Saving may be defined briefly as the difference between current income and current consumption, investment as the value of additions to the stock of goods in the country (home investment) plus the increase in claims on foreign countries and in gold holdings (foreign investment). The numerous problems connected with these definitions lie outside the scope of this paper.

[4] Strictly speaking, this statement requires the additional condition that both home and foreign investment as well as total investment should be zero.

port. If, for example, with unchanged exports there is a shift in demand from imported to domestic goods, incomes will rise to the point where imports are restored to their former value.

Both the average and the marginal propensity to import are determined by a multitude of factors. The division of an individual's expenditure between imports and domestic goods is influenced by the schedule of his preferences for different goods, relative prices at home and abroad, and the size of his income, while for the community as a whole it is also affected by the distribution of the national income between individuals of different tastes and different incomes. The important point for our purposes is that the level of income is one of the principal factors in determining imports, higher incomes being generally associated with higher imports and lower incomes with lower imports.

It may be noted that it makes a great deal of difference whether or not resources are fully employed. If they are, an increase in foreign demand for exports will result in higher prices at home, which will in turn cause a shift to imported goods. Money incomes will increase, but employment will not. If, however, there is widespread unemployment of resources, prices may remain unchanged while output expands, real and money incomes will rise together, and imports will increase because of the higher level of income. Or the outcome may be intermediate between these two cases, both prices and output increasing. In the remainder of this paper we shall assume that an increase in demand results in some expansion of output, either with or without an accompanying rise in prices.

Saving and Investment Taken into Account

The foregoing analysis is, of course, merely a translation of the familiar multiplier concept into foreign trade terms. If investment is substituted for exports and saving for imports, the analysis can be applied almost *verbatim* to a closed economy in which saving and investment take place. If we consider an economy with foreign trade and saving and investment, the two analyses must somehow be combined. For our purposes the most satisfactory method of effecting the combination is to consider investments and exports as the autonomous factors, changes in which have a multiplied effect on income. The

multiplier is the reciprocal of the marginal propensity to save plus the marginal propensity to import.[5] With a given propensity to save, the higher the marginal propensity to import the smaller the multiplier. In any open economy the multiplier is smaller than in a closed economy with the same propensity to save.

Other Links Between Exports and Imports

This form of the multiplier emphasizes the effect of changes in investment and exports, through the medium of incomes, on saving and imports. But the export-income-import sequence is not the only line of connection between exports and imports. If it were, foreign investment or disinvestment in the form of gold or capital movements would have to take place freely to cover any surplus or deficit of exports that might arise, and this gold or capital movement could not independently affect exports or imports. In fact, however, this is not the case. In order that the use of the multiplier analysis should not be misleading, it will perhaps be advisable to mention at this point the other lines of relation between exports and imports, although to discuss them would involve a digression into the theory of international adjustment.[6]

[5] This formulation is used in Colin Clark and J. G. Crawford, *The National Income of Australia* (Sydney and London, 1938), pp. 90–103. Perhaps the most familiar formulation is that in which the multiplier is the reciprocal of the marginal propensity to save, and the export *balance* an autonomous factor. The disadvantage of this formulation, as Colin Clark points out (cf. "The Determination of the Multiplier from National Income Statistics," *Economic Journal*, Sept., 1938, pp. 438–39) is that it includes imports among the autonomous factors whereas it is often better to regard them as a function of income. The formulation used in the text, on the other hand, is defective in that it diverts attention from relations between exports and imports other than the export-income-import sequence, as is pointed out below.

Any formulation is formally correct, though not necessarily useful, if the product of the autonomous factors and the multiplier is equal to the change in income, assuming that the functions do not shift. A convenient symbolic presentation may be found in D. H. Robertson, "Mr. Clark and the Foreign Trade Multiplier," *Economic Journal*, June, 1939, pp. 354. The formulation used here is Professor Robertson's (iii). For other discussions of the multiplier in an open economy see R. F. Harrod, *The Trade Cycle* (Oxford, 1936), pp. 145–158. R. W. Jastram and E. S. Shaw, "Mr. Clark's Statistical Determination of the Multiplier," *Economic Journal*, June, 1939, pp. 358, F. W. Paish, "Banking Policy and the Balance of International Payments," *Economica*, Nov., 1936, pp. 404, and A. F. W. Plumptre, "The Distribution of Outlay and the 'Multiplier' in the British Dominions," *Canadian Journal of Economics and Political Science*, August, 1939, pp. 363.

[6] In view of the controversy that has centered around the multiplier approach to income, I should like to say that I have used it here because I find it a convenient vehicle for expressing the ideas in the second and third sections of the paper. It is convenient because it focuses attention on a relationship which I consider important. Any reader who dislikes the terminology may translate the substance of

1. In gold standard countries, gold flows may cause interest rate changes which alter both incomes and relative prices and costs of domestic and foreign goods.
2. In paper standard countries, movements of the exchange rate may alter relative prices and costs of domestic and foreign goods.
3. In exchange control countries, the entire balance of payments, and therefore the relation of exports to imports, is directly subject to administrative determination. In other countries, tariffs and quotas may be imposed to protect the balance of payments or they may be removed when strain on it disappears.
4. Any of the above adjustments taking place in other countries in response to a change in one country's balance of payments will affect the balance of payments of the first country. For example, if country A increases its imports from country B, B may, for any of the above reasons, increase its own imports, and A's exports will share in the increase.

All these factors must be considered in a discussion of the balance of payments. Nevertheless, it was well to emphasize the importance of the multiplier and the marginal propensity to import on the simplest assumptions because that particular relation has not, until recently, received much attention. Furthermore, for free exchange countries with relatively stable exchange rates, it is the most automatic, and, in the short run, perhaps the most important form of adjustment.

FOREIGN TRADE IN THE BUSINESS CYCLE

In analyzing the part played by exports and imports in transmitting fluctuations in economic activity from one country to another, we shall proceed in two stages. In the first we assume that only the pure multiplier effect operates, that is, that the relation between imports and income is given, and that exports are determined only by changes in foreign demand. In the second stage we drop this assumption and consider the interrelations between exports and imports mentioned above.

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those sections into any other terminology he prefers without affecting the argument. If he objects that the apparatus diverts attention from other important relationships, I should readily agree, hastening to add that I am not attempting to cover the entire subject but only to discuss certain aspects of it.

Only the Multiplier Effect Considered

On the simplified assumption, the role of foreign trade is easily described. The larger a country's exports relative to its total national income, and the greater the fluctuations in exports, the larger will be their influence in initiating fluctuations in income. The greater the marginal propensity to import, the smaller will be the effect on home incomes of a given change in exports or home investment.

At this stage there is but one complication to consider. It may best be brought to light by assuming that there are only two countries, A and B. If A decreases its imports from B, B's income will be reduced, and its imports as well. But since A supplies all of B's imports, this means a reduction in A's exports and a fresh decline in its income. Hence a decline in A's imports affects exports and income.[7]

In the actual world, of course, the situation is complicated by the existence of a large number of countries. A decline in A's imports from B will affect B's imports not only from A, but also from C, D and E. These countries in turn will import less, and part of the burden will fall on A's exports to them. If world trade were evenly distributed, that portion of the decline in total imports falling on A's exports would be equal to A's share in world exports. But trade is not evenly distributed in this sense. For example B may supply 25 per cent of A's imports though it supplies only 5 per cent of total world imports. If A reduces its imports from B, the reaction on its own exports will be greater if B buys mainly from A than if B's imports are obtained from C, D, and E.[8] The repercussions on a country's exports of a change in its imports will be greater, other things being equal, if the countries which supply most of its imports are also the principal customers for its exports.

Summarizing, we may conclude that the reaction of a change in a country's imports on its exports will be greater:

1. The greater are the marginal propensities to import and the multipliers of the countries from which it imports.

[7] The multiplier in B determines the ratio of the decrease in income to the original drop in exports, the marginal propensity to import that of the reduction in imports to the decrease in income. Since the marginal propensity to import is itself a determinant of the multiplier, the relation between the reduction in imports and the marginal propensity to import is somewhat more complicated.

[8] This will be true even if A sells heavily to C, D, and E, because reduction in their exports to B will probably be greater than the resulting fall in their imports.

2. The greater is its share in world trade.
3. The more heavily are its exports concentrated on those countries from which it imports most.

Action to Alter the Balance of Payments Considered

It has been assumed up to this point that only the pure multiplier effect has been allowed to operate, that is, that the operation of the multiplier provides the only causal connection between exports and imports and that home investment is independent of both. Proceeding to the second stage of the analysis, we drop that assumption. The discussion falls into two parts, the response of a country to a change in its exports, and the effect of a change in domestic conditions on imports and exports.

When a country's exports fall off, the effects on it are twofold. Not only does the reduction in exports have a multiplied effect on income, but in addition the balance of payments is subjected to pressure because although a decline in imports will take place, it must be smaller than the original loss of exports if the marginal propensity to import is less than one.[9]

In this situation, a country can allow the multiplier effect to operate freely or it can take any of three lines of action:

1. The traditional gold standard behavior is to deflate at home in order to restore equilibrium in the balance of payments. Such a policy would further reduce money incomes and probably real incomes as well.
2. Another choice, directly antithetical to this, is to offset the effect on incomes on the loss of exports by using monetary and fiscal measures to stimulate home activity. While sustaining home incomes, such a course will aggravate the tendency toward a deficit in the balance of payments.
3. Finally, it can alter the balance of payments by allowing the exchange rate to depreciate in response to the original drop in exports, or by employing tariffs, export bounties or other devices designed either to stimulate exports or reduce the propensity to import or both. Action of this sort has the double effect of forestalling both the decline

[9] We are ignoring the possibility that the decline in income will cause a secondary reduction in home investment, which in turn will result in a further decline in income and imports.

in money income and the pressure on the balance of payments (although it cannot offset the decline in real incomes caused by the adverse change in the terms of trade).

All three of these policies are directed at the immediate situation created by the decline in exports. In the long run, however, still a another policy is possible. The country can attempt to insulate itself from fluctuations originating in other countries by reducing its dependence on foreign trade in general, diverting expenditure from imports to home-produced goods and selling more of its production at home and less in the export markets. Such a policy may be adopted because the domestic economy is considered freer from cyclical fluctuations than the export markets, or it may be a prelude to a comprehensive program designed to eliminate fluctuations. In either case, if the policy is to be justified, it must be shown not only that the domestic market must prove more stable than the export markets, but also that the gain in stability outweighs any loss in efficiency that may result from the reduced volume of international trade.[10]

A less drastic method of insulation is to join several countries into an economic bloc and endeavor to maximize trade between members of the bloc at the expense of trade with the outside world. Here again, the bloc may be formed because it is thought that business cycles in the member countries are comparatively mild, or it may be a prelude to a joint effort to control them.

Where domestic factors initiate an increase in home income and in imports, a country is confronted with much the same choices. By deflating it can protect the balance of payments at the cost of choking off the domestic expansion. By depreciating or employing protectionist measures it can enjoy the full effects of the domestic expansion and avoid the strain on the balance of payments. Finally, it can allow the multiplier effects on income and imports to operate freely. Such a policy will be possible, for example, if receipts on current account were originally greatly in excess of payments, so that the effect of the expansion is only to turn a large surplus into a small one, or if there are substantial reserves of gold and foreign assets, or if the country is able and willing to borrow abroad. Under

[10] Military and other non-economic considerations may be even more important than the economic factors mentioned here in determining what degree of self-sufficiency is desirable.

such a policy, some of the stimulating effect of the domestic expansion will be spilled over to foreign countries.

A fourth possibility is to expand at home, but conserve the stimulating effect on income and protect the balance of payments by bilateral trade policies. It has been stated above that change in a country's imports may react upon its exports. Ordinarily this reaction will be quite small. The objective of bilateralism is greatly to increase it, to insure that the full amount of the rise in imports is reflected back on exports. This end can be achieved by a commercial policy that provides for a close balance of bilateral trade by means of barter and clearing arrangements.

We have seen that a single country may employ exchange depreciation or protective measures of some variety as a supplement to a program of internal expansion. Under those circumstances I think depreciation would generally be regarded as justifiable if not carried too far, since its unfavorable effects on other countries are offset by their gains from the expansion program, leaving their balances of payments and national incomes on balance unaffected. But there is another situation in which depreciation would be just as generally condemned: when it is used, not as a supplement to, but as a substitute for the stimulation of internal activity. Instead of raising home investment, a country can restore its income by stimulating exports and restricting imports, and the latter course may appear the more expedient. When undertaken for this purpose, depreciation is branded as a beggar-my-neighbor policy, since it enables the depreciating country to obtain a larger share of total world income without increasing that total.[11]

Once we attempt to distinguish between justifiable and unjustifiable depreciation, however, we raise the whole issue of equilibrium in the balance of payments and the equilibrium exchange rate. When a country depreciates, its rivals will attack its action as an unjustified attempt to gain at their expense and will call for retaliatory measures. The depreciating country in turn will often reply that it is merely restoring its balance of payments to an equilibrium which has been upset at some previous time. In the ensuing controversy, relative

[11] This statement requires qualification. If the multiplier has different values in the depreciating country and in the countries which suffer from the depreciation, or if the shift in trade affects investment, total incomes will change, but the movement may be in either direction, depending on the particular circumstances.

costs and prices receive much attention. Without going into the problem, I wish merely to point out that whatever "international equilibrium" may be, relative income levels enter into it as well as relative costs and prices.

To summarize, a country can attempt in its foreign trade policy to influence:

The *balance* of trade. By increasing exports and diverting demand from imported to home-produced goods, it can expand money income and, to a smaller extent, real income. In a world of unemployed resources, improving the trade balance is one way, though perhaps not the best way, to raise employment. But a country may be unable to improve its balance if others are simultaneously attempting to improve theirs, or if they retaliate against any action it takes. Furthermore, there may be better ways of increasing employment, so that action of this sort may be both difficult and unnecessary.

The *amount* of trade. Even if a country is powerless to alter its foreign balance, it may still be able to influence the total amount of its foreign trade, increasing or decreasing exports and imports together. A country that is subject to violent cyclical fluctuations might try to increase its trade relations, one with only moderate swings to reduce them. The amount of trade is likely to be subject of long-term policy, the balance a matter of the short run.

The *direction* of trade. A country might direct its trade into more or less bilateral channels for much the same reasons as would lead it to increase or decrease the total amount of trade.

Both depreciation (or other measures to improve the balance of trade) and bilateralism provide the freedom of action for internal expansion, the former by creating a surplus in the balance of payments, the latter by minimizing the deficit when the expansion materializes. By themselves, however, neither supplies the motive power for an expansion of world income. If they are not implemented by an aggressive domestic monetary or fiscal policy, bilateralism will result only in a less efficient use of resources and reduced real income, depreciation in some improvement in the home country at the expense of the rest of the world.

FOREIGN TRADE AND NATIONAL INCOME IN THE UNITED STATES AND OTHER COUNTRIES

In the previous sections we have reached some conclusions with respect to the relations between the national income and foreign trade. Our present task is to apply these conclusions to the United States. In doing so, we will have occasion to discuss the position of other countries as a basis for comparison.

It is, of course, well known that foreign trade plays a smaller part in the economy of the United States than in that of most countries. Table 1, which shows the percentage of exports to national income for selected countries, will serve to give a rough indication of the magnitude of the differences. It should be noted, however, that this table gives the percentage for exports alone, not for the total of income received from the sale of goods and services to foreigners. The figures range all the way from 4 per cent in the United States to 36 per cent for New Zealand in 1936.

TABLE 1

EXPORTS OF SELECTED COUNTRIES AS PER CENT OF NATIONAL INCOME

Country	1929	1932	1936
United States	6	4	4
United Kingdom	17	10	9
Germany	18	13	7
Sweden	24[a]	15	18
Canada	23	18	21
New Zealand[b]	27	28	36
Denmark	46	33	33

[a] 1930 figure.

[b] Figures are for years beginning April 1.

Sources: National income figures from League of Nations, *World Economic Survey*, 1938–39, p. 84. Export figures from statistical yearbooks or abstracts of each country except figures for Denmark which are from League of Nations *International Trade Statistics*.

For countries in widely differing positions different monetary and foreign trade policies are appropriate. For example, a program of domestic expansion unaccompanied by any action to protect the balance of payments will result in a large increase in home incomes and a small adverse change in the balance of payments (leaving purely domestic factors out of account): (1) if the marginal propensity to import is small, and (2) if the reaction on exports of a given increase in imports is great.

Incidentally, this proposition enables us to give more precise meaning to the common but unsatisfactorily vague statements that a "large" country has greater monetary autonomy than a "small" one. The statement is correct if a "large" country is one whose imports are a small portion of its own national income, but whose exports are a large fraction of world exports, for one would expect the marginal propensity to import in such a country to be low, and the reaction on exports of a change in imports to be high. In general, we may say that a country may pursue an independent monetary policy without regard to the balance of payments if foreign trade plays a small part in its economy, but its foreign trade is a sizeable portion of world trade.

It is obvious that no country meets these conditions nearly so well as the United States. American merchandise exports are larger than those of any other country (though total receipts on current account are exceeded by those of England) while the ratio of imports to income is smaller than that of any important country. In the year 1936 they were only 4 per cent of income, compared with 16 per cent in Great Britain and 6 per cent in Germany, the only other countries whose exports compare with those of the United States.[12] An additional reason why the United States can pursue an independent policy of expansion is that the size of our gold reserve enables us to regard a substantial deficit in our balance of payments with equanimity.

Some Foreign Experiences

A country less favorably situated than the United States can usually carry through an internal expansion if adequate measures are taken to protect the balance of payments.[13] A remark-

[12] These percentages correspond to what we have called the average propensity to import, whereas it is the marginal propensity that is relevant here. The marginal propensity, i.e., the ratio of a small change in imports to the change in income that caused it, is difficult to measure because in fact imports are affected by other factors than income. There is no stable relation between imports and income in Great Britain. For the United States, annual changes in total payments on current account were in general about one-tenth as large as annual changes in income in the period 1926–1939, and this relation seems to hold fairly consistently throughout the period. Although that fact does not justify the conclusion that the marginal propensity to import in the United States is one-tenth, it supplies partial evidence that it is comparatively small. It is of interest to compare the American figure with the value of .25 which Clark and Crawford found for Australia for the period 1930–1938 (*National Income of Australia*, p. 100).

[13] This does not mean, of course, that it can offset all the effects of a decline in the demand for its exports, for such a decline will lead to a more or less serious

able example of the use of bilateralism to protect the balance of payments is provided by the experience of Germany in the period 1933–1939.[14] In the absence of drastic measures of some sort to protect the balance of payments, Germany was in no position to effect an expansion. Imported raw materials were essential to any increase in production and particularly in the sort of production that dominated the German expansion—production for military purposes. Gold reserves were negligible and it was impossible to borrow abroad except by a novel device—the accumulation of debit balances in clearing accounts with other countries.[15] Hence the necessary imports could be obtained only by a simultaneous expansion in German exports. A policy of aggressive bilateralism coupled with export subsidies was adopted as the method of securing the expansion of exports. As a result of this policy, an increase in German imports from any country insured a corresponding increase in purchases by that country from Germany. The demand for German exports was thus closely tied to Germany's demand for imports.

If circumstances are favorable, a small country producing largely for export will be able to carry through an internal expansion if it takes adequate measures to protect the balance of payments. But under adverse conditions, such an expansion may prove impossible. Just how serious are the limitations imposed by the balance of payments under such conditions is illustrated by a comparison of the experiences of Denmark and Sweden between 1932 and 1935.[16] It is true that foreign trade bulks considerably larger in the Danish economy than in the Swedish, exports representing in 1932 33 per cent of the Danish national income as against only 15 per cent of the Swedish, but this fact will not materially affect the comparison.

Early in 1932 both Sweden and Denmark initiated easy money programs. In both, the central bank discount rate was reduced in successive stages from 6 per cent at the end of 1931 to 2½ per cent in 1933. The Swedish government, in addition, launched a public works program in 1933. The rapidity and

reduction in real income no matter what internal policy is adopted. It can, however, sustain money income and perhaps employment.

[14] I am indebted to Mr. Emile Despres for this interpretation of German commercial policy.

[15] This section is based almost wholly on Carl Iversen, "The Importance of the International Margin," in *Explorations in Economics* (New York, 1936).

[16] *Ibid*, p. 75.

completeness of Sweden's recovery has so often been described that there is no need to repeat the story here. The only point that need concern us is that the balance of payments position was highly favorable. Exports increased considerably because of the depreciation, and later the British building boom created a demand for Swedish timber while German rearmament required large quantities of Swedish iron ore. At the same time, there was a large inward capital movement with the result that reserves of gold and foreign exchange rose continuously. (In fact it may be that the easiness of money was due at first to the expansion of the Riksbank's foreign assets rather than to any deliberate policy.)

Denmark's experience was far less fortunate. The stimulus of easy money was concentrated largely on construction activity. Since the bulk of building materials is imported, more construction requires considerably higher imports—the marginal propensity to import is abnormally high. But the international position did not permit any increase in imports. Since gold and foreign exchange holdings were small, and there was no reserve of foreign securities to draw upon, more imports could be obtained only by increasing exports. Great Britain, which took over 60 per cent of Danish exports, was by far the principal customer for Denmark's intensive agriculture, while Germany, with 13 per cent, was in second place. Special circumstances restricted Danish exports to both these countries. Where Sweden had the good fortune to produce the raw material for German guns, Denmark supplied only butter (and other pork and dairy products), of which Germany was consuming as little as possible, while, as Table 3 below shows, part of the British market was lost to New Zealand as a result of empire preference. Nor could depreciation be invoked to assist exports, since both German and British demand was inelastic. If Germany had obtained butter at lower prices, she would have used the savings to purchase still more guns, not more butter. England subjected her imports from Denmark to direct quantitative limitation in the form of quotas. Furthermore, it was impossible to finance a deficit on current account by the liquidation of foreign assets. While the Swedish gold and foreign exchange reserves rose steadily between the end of 1931 and the end of 1935 from 500,000,000 to 1,250,000,000 kroner, Danish holdings shrank from kr. 150,000,000 to kr. 25,000,000

in the same period.[17] Nor did Denmark have any stock of foreign long-term securities, such as Sweden possessed, to draw upon.

Even a thorough-going system of import controls instituted in 1932 to insure that only essential materials were imported did not suffice to overcome the difficulties, according to Iversen.[18] In spite of the low official discount rate, the yield on government securities never fell much below 4 per cent, although in Sweden it dropped to 3 per cent.[19] The easy money program was finally abandoned early in 1935, the central bank raising its discount rate to 3½ per cent in that year and to 4 per cent in 1936. Apparently the balance of payments responded to the reversal of policy; the import surplus was reduced from kr. 114,000,000 in 1934 to 62,000,000 in 1935, and the entire balance on current account shifted from a deficit of kr. 38,000,000 to a surplus of 40,000,000.[20] Where a favorable balance of payments situation reënforced the program of internal expansion in Sweden, the unfavorable course of the balance of payments defeated the Danish program.

In the British recovery of 1932–37, international and domestic factors are intertwined in a complicated manner. On the domestic side, easy money and the housing boom contributed heavily to the completeness and promptness of the recovery. But it is questionable how effective they would have been in the absence of depreciation, the tariff, and the Ottawa agreements. Each of these measures operated in a different way to improve the international position. Depreciation acted as a stimulus to exports and a check on imports, except to the extent that it was offset by counter-action in competing countries. The Ottawa agreements, by giving Great Britain preferential treatment in the dominion markets, stimulated exports, although the stimulus was in part offset by retaliation by other countries. The tariff substituted home production of manufactured goods for imports. Its effect is strikingly brought out

[17] The objective of control was not only to limit the total but to shift the distribution of imports in favor of Great Britain, in order to reduce the export surplus and consequent weak bargaining position with respect to that country.

[18] League of Nations, *Monetary Review, 1938*, pp. 138–140.

[19] It is impossible to tell without further study how great a part the change in monetary policy had in this shift. Iversen implies that it was largely responsible. *Op. cit.*, p. 76.

[20] For a more extended discussion of the British recovery, see George Jaszi, "The Budgetary Experience of Great Britain in the Great Depression," in *Public Policy* (Cambridge, 1940).

TABLE 2

British Imports of Manufactured Goods 1924–1937

Year	Total Imports	Selected Manufactures			
		Iron and Steel	Cotton Products	Woolen Products	Apparel
1924–28	(1931=100)				
average	145	130	111	108	90
1929	142	125	122	123	100
1930	121	115	111	100	95
1931	100	100	100	100	100
1932	82	45	22	15	32
1933	78	30	22	15	37
1934	85	45	22	15	37
1935	88	45	22	15	37
1936	98	60	33	23	37
1937	119	100	33	31	47

Source: *Statistical Abstract of the United Kingdom, 1913 and 1924 to 1937*, pp. 402–407.

by Table 2. Imports of manufactured goods were reduced from 31 per cent of total imports in 1931 to 22 per cent in 1932, but this fact is not conclusive because the percentage later recovered to a figure not far from its 1924–1929 average, and because the classification "manufactures" includes a large number of semi-manufactured materials that are not competitive with British products. But when we turn to the imports of goods most highly competitive with British products, shown in Table 2, there is no mistaking the effects of the tariff. Imports of iron, steel, cotton, and woolen manufactures and clothing declined drastically after 1931. Only iron and steel imports regained their former level, and that was because of a domestic shortage in 1937 which resulted in a reduction in some of the duties. The shift of expenditure from imported to domestic goods must have contributed a substantial stimulus to the British economy.

The British recovery was due primarily to expansion of the home market, and in fact there was a rather remarkable reduction in the role of foreign trade. Exports, which averaged 17 per cent of national income in the period 1924–1929, fell to 9 per cent in 1933–1938, while the average for imports dropped from 26 per cent to 17 per cent. Nevertheless, the improved foreign trade position brought about by depreciation, the tariff, and empire preference was probably indispensable to the domestic expansion.

All three of these measures acted in a straightforward manner both to improve the international position and to provide leeway for an internal expansion. But the Ottawa agreements had an additional effect. They favored imports from the dominions, which obtain a large fraction of their imports from Great Britain, at the expense of non-British countries which buy a considerably smaller portion of their imports in England. For example, the agreements resulted in a shift of British purchases of dairy products away from Denmark, which in 1931 took only

TABLE 3
UNITED KINGDOM IMPORTS FROM DENMARK AND NEW ZEALAND, 1924–1937
(In millions of pounds sterling)

Year	Denmark	New Zealand	Imports from New Zealand as Per Cent of Imports from Denmark
1924–29 average	50.5	40.5	81
1930	53.6	40.3	75
1931	46.2	33.7	73
1932	40.3	33.2	82
1933	35.2	31.9	91
1934–37 average	33.5	37.8	113

Source: *Statistical Abstract for United Kingdom, 1913 and 1924 to 1937*, pp. 378–9.

15 per cent of its imports from England while sending 60 per cent of its exports there, in favor of New Zealand, in whose imports the British share was 50 per cent in 1931, and which sold 88 per cent of its exports to Great Britain.[21] This shift is reflected in Table 3. The result was to increase the demand for British exports which would result from any future rise in imports. By increasing the interdependence of Great Britain and the empire, empire preference added to Britain's monetary autonomy.[22]

As Table 5 shows, this tendency toward the formation of economic blocs, in most cases based on imperial relations, is by

[21] League of Nations, *International Trade Statistics.*

[22] I do not mean to imply that the negotiators sought this result; on the contrary, they were probably interested only in the purely protective aspect of the agreements. Another by-product of imperial preference was an increase in British exports to the countries that were unfavorably affected. In order to secure more favorable treatment for her exports, Denmark increased her purchases in Great Britain from 15 per cent of her total imports in 1931 to 38 per cent in 1937. As Table 4 shows, this shift was made at the expense of Germany and the United States.

TABLE 4

DISTRIBUTION OF DANISH IMPORTS BY PRINCIPAL COUNTRIES, 1932–1937

Year	United Kingdom	Imports from Germany	United States
	(Per cent of total imports)		
1929	14.7	32.9	13.3
1931	14.9	33.5	10.5
1932	22.3	25.1	7.7
1937	38.1	24.1	5.2

Source: League of Nations, *International Trade Statistics.*

no means confined to the British countries. There can be no doubt that it is closely associated with world depression and that it enhances the opportunities of individual countries to raise themselves above the general level by their own action, at the same time increasing the chance that they will be pushed below it by the action of others. If all countries recover in unison, such an opportunity is not necessary, but in fact recovery from the great depression was very uneven.

TABLE 5

TRADE OF CERTAIN COUNTRIES WITH THEIR ECONOMIC "BLOCS"

Country	Economic Bloc	Trade with Bloc (Per cent of total trade)					
		Imports			Exports		
		1929	1932	1938	1929	1932	1938
United Kingdom	British Empire	30	36	42	44	45	50
United Kingdom	Other sterling countries[a]	12	13	13	7	10	12
France	French Empire	12	21	27	19	32	28
Japan	Japanese Empire[b]	20	33	41	24	30	55
Germany	6 countries of Southeast Europe[c]	5	6	12	5	4	13

[a] Sweden, Norway, Finland, Denmark, Egypt, Iraq, Esthonia, Latvia, Portugal, and Siam.
[b] Korea, Formosa, Kwantung, and Manchuria.
[c] Bulgaria, Greece, Hungary, Roumania, Turkey, and Jugoslavia.
Source: League of Nations, *Review of World Trade*, 1938, pp. 34–35.

The Position of the United States

Returning to the United States, we have already seen that exports represent a comparatively small fraction of total production. Table 6 shows that home investment is not only considerably larger but also that it is subject to far wider fluctuations, both absolutely and relative to its average value,

than receipts on international account. In the decade 1929–1938, gross capital formation averaged about $11,000,000,000, and the mean deviation was almost $5,000,000,000, or 45 per cent of the average, while the average for receipts on international account was only $4,000,000,000, with a mean deviation of just over $1,000,000,000 or 28 per cent.

TABLE 6
NATIONAL INCOME, RECEIPTS ON CURRENT INTERNATIONAL ACCOUNT AND GROSS INVESTMENT IN THE UNITED STATES, 1929–1935
(*In billions of dollars*)

Year	National Income	Receipts on Current International Account	Gross Capital Formation
1929	82.7	6.9	20.3
1930	69.1	5.4	13.7
1931	54.2	3.5	8.5
1932	40.1	2.4	3.0
1933	42.5	2.3	3.6
1934	50.6	2.9	5.2
1935	55.8	3.3	9.5
1936	65.2	3.5	14.1
1937	71.9	4.6	17.5
1938	64.0	4.3	12.0

Sources: National income from *Survey of Current Business*, June, 1939. Receipts on Current Account from *Balance of International Payments*. Gross Capital Formation 1929–31 from Simon Kuznets, *National Income and Capital Formation*, p. 40, 1932–1938, from Kuznets, *Commodity Flow and Capital Formulation in the Recent Recovery and Decline.* (Bulletin No. 24 of National Bureau of Economic Research), p. 2. Figure for 1932–1938 is gross capital formation less net addition to claims against foreign countries.

Furthermore, the American economy has in the last decade functioned at an unsatisfactorily low level. As long as the fluctuations are violent and the level low, our relative independence of foreign trade is, from the cyclical point of view, no asset but a positive liability. The more our economy is isolated from the outside world, the more intense are the effects of fluctuations originating within it, and the less the repercussions of outside fluctuations. The decision as to what volume of trade is desirable must take into account the probable relative levels of economic activity and the probable violence of fluctuations at home and abroad in the future. Past performances would indicate the desirability of economic internationalism, though current trends may well point in the opposite direction. In any event, there is no necessary presumption in favor of insulation.

It is often said that the demands of domestic prosperity

should not be sacrificed to the maintenance of an international standard. There is nothing in the preceding argument to controvert this proposition: on the contrary, it is precisely domestic prosperity that we have been considering. But the proposition is usually followed by the argument that we should, by means of variable exchange rates or economic isolation, protect the economy from outside fluctuations, particularly deflationary tendencies. This argument ignores the fact that internal as well as external forces may be responsible for fluctuations; if they are, fixed exchanges and the closest possible economic relations with foreign countries will cushion their impact on the domestic economy and divert it to the world outside. Furthermore, policies designed to combat a depression are hampered by international factors only when recovery in the home country is outdistancing that in the rest of the world, a situation which is by no means inevitable.

The 1937–38 depression illustrated the part that foreign trade can play under exceptionally favorable circumstances. At the peak of the 1937 recovery, our merchandise balance was negative by some $50,000,000 a month and the entire current account was probably about in balance. In the autumn we suffered one of the most precipitous downswings of activity in our history, the Federal Reserve Board's index of industrial production dropping from 117 in August to 80 in January 1938.

TABLE 7

Industrial Production and Foreign Trade of United States, 1937–39

Period	Industrial Production	Imports	Exports
	(seasonally-adjusted indexes, 1923–25=100)		
1937—1st quarter	116	82	64
2nd "	117	87	78
3rd "	114	81	78
4th "	91	67	75
1938—1st "	80	50	74
2nd "	77	46	72
3rd "	87	52	65
4th "	101	54	62
1939—1st "	99	52	63
2nd "	94	57	68
3rd "	105	57	71
4th "	124	72	77

Source: Department of Commerce, *Survey of Current Business*, 1940 Supplement.

As the accompanying table shows, the down-turn was clearly reflected in imports, which dropped by one-third from 1937 to 1938. Exports, however, were maintained not far from their 1937 levels and the export surplus remained close to $100,000,000 a month from October 1937 through the greater part of 1938. In its origin, the depression was almost entirely an American phenomenon; to the extent that activity in other countries declined it was mainly as a result of deflationary forces originating in the United States. Of course, there was a special reason for the maintenance of activity in the other industrial countries, the intensification of rearmament. The fact remains that the pressure on the American economy was somewhat relieved by the sharp drop in imports. If the United States had been a closed economy with no imports, the full force of the decline in expenditure would have been concentrated on home activity; if imports had been larger, still more of the burden would have been shifted.

Although the place of foreign trade in the American economy may be small as compared with its position in most countries, our trade is an important component of the total trade of the world. Our imports are exceeded only by those of the United Kingdom. Since imports are largely determined by home incomes, the level of economic activity in the United States is of the highest importance to the rest of the world. A billion dollar increase in the national income of the United States may be accompanied by a smaller increase in our imports than an equal rise in, say, the Swedish national income, but a 10 per cent rise in American incomes will have a far greater absolute effect on our imports, and therefore on the exports of other countries, than a 10 per cent rise in Sweden, or for that matter in any other country except the United Kingdom or Germany.[23]

The importance of American demand in world markets was clearly demonstrated in the 1937–38 depression referred to above. According to the *Review of World Trade*, "the United States accounts for nearly one-third of the total decline in world

[23] Of course our import demand is not spread uniformly over all countries and all commodities. There is no reason for describing in detail the distribution of trade, except to point out that the producers of certain raw materials such as rubber are particularly dependent on American demand and that our trade with the British empire takes a triangular form, since we ordinarily have a large excess of imports in our trade with the colonial empire and India and a large export surplus with respect to Great Britain, while Great Britain's sales to its colonies plus its income from colonial investments are greater than its purchases from them.

imports and for about half the decline in the trade in raw materials between 1937 and 1938."[24] The resulting adverse shift in the balances of payments of the raw material countries forced them to sell gold and foreign exchange on a large scale, to depreciate their exchanges, or to reimpose or tighten exchange controls.[25]

The United States is a highly important market; if it is also an unstable and depressed market, that fact must exert a strong influence toward world instability and depression. Many countries resort to exchange control and trade restriction in their attempts to resist the impact of depressing forces either on their balances of payments or their incomes. Like so many other economic problems (those of inflexible prices and low farm income suggest themselves), that of economic nationalism is in part simply a facet of the broad problem of depression. This is not to say that economic nationalism would disappear with prosperity, but only that its magnitude would be considerably reduced, and that it would no longer be much cause for concern on purely economic grounds.[26]

The growth of restrictions on trade is deplored in many circles and the administration is committed to an effort to reverse the trend. There can be no doubt that the American depression of the 30's is to a considerable extent responsible for the tendencies that are regarded as undesirable. Where trade barriers are raised to stimulate employment the situation is eminently suited to bargaining because a reciprocal reduction of trade barriers may be in the interest of both parties where unilateral action would not. It will presumably not injure employment, since each country gains a share in the other's market while giving up a portion of the home market, while it will bring about a somewhat more efficient use of resources. Nevertheless, the possibilities of such action seem to be distinctly limited, and it is questionable whether much more remains to be done. Any further relaxation must await the revival of prosperity.[27]

[24] League of Nations, *Review of World Trade*, 1938, p. 19.

[25] For discussions of the impact of the American depression on the raw material countries, see *Federal Reserve Bulletin*, June, 1938, pp. 427–430, and League of Nations, *World Economic Survey*, 1937–38.

[26] Political and military considerations would still be operative, but they are another matter.

[27] These remarks do not apply to the present war-time situation. They were relevant to the pre-war world; whether or not they will be relevant to the post-war world depends on the economic and political organization of that world.

The conclusion is not that we should secure domestic prosperity—that is already obvious. It is rather that *unless* we achieve prosperity, we cannot expect to free foreign trade from the regimentation which we find so distasteful on political grounds. Furthermore, we shall be disappointed if we hope to use foreign trade to achieve prosperity, either through reciprocal agreements or by unilaterally pushing our exports.[28] If, however, we succeed in obtaining a high level of national income, resulting in higher imports, we will have a good chance of securing some relaxation of trade restrictions and of obtaining favorable treatment for our exports.[29] Failing in our domestic program, we may expect a continuation of the tendency toward controlled foreign trade and bilateralism.

[28] I do not mean to exclude the possibility of a strong war or post-war demand for our exports, or to deny that we can sell our goods abroad if we extend loans to finance them.

[29] This statement applies particularly to many Latin American countries, which would greatly increase their purchases in the United States if they had sufficient dollar exchange.

THE EFFECT OF GOVERNMENTAL EXPENDITURES AND TAX WITHDRAWALS UPON INCOME DISTRIBUTION, 1930-1939

Charles Stauffacher

SUMMARY

SINCE *the 1920's the role of government has become increasingly important in affecting income distribution in our society. The growth of the concept of the nation as an economic entity presents new areas within which to seek the solution of economic problems.*

Upon the basis of broad estimates governing the assignment of governmental payments to income groups, and the incidence of taxation upon these same income groups the extent of the transfer of income from well-to-do and wealthy groups to those lower on the economic scale is shown. This analysis brings out clearly the primary importance of debt creation since 1933 as the main factor which accounts for the real swing in favor of the working classes. Payments from federal government fall into three categories: payments for personal services, payments made by virtue of contractual obligations and payments for supplies and materials. These payments are broken down into salaries, wages, and returns on capital, and are discussed in detail.

Over the decade of the 1930's, payments from the national government have accounted for 27.1 per cent of the income of those receiving below \$780 per year. This group has received 26.8 per cent of the direct income from governmental expenditures, while contributing 5 per cent of the tax revenues. Those in the income group receiving over \$15,000 per year, have contributed, 39.7 per cent of total tax revenues and have received 16.2 per cent of the direct income from governmental expenditures. Effective rates of taxation, figured on the aggregate ten-year period range from 3.3 per cent to 27.1 per cent with a large margin between the highest and second highest rate. The ending of the decade of the 1930's seems also destined to end the reign of relief expenditures as the dynamic element in federal income payments. The swing from this type of expenditure to larger appropriations for national defense may well shift the emphasis on federal income payments toward the higher income brackets unless policies designed to prevent such a shift are adopted.

THE EDITORS

THE main interest of this paper lies in the process by which some reasonable estimates of the effect of federal taxation and expenditures upon income distribution may be made. This is essentially a statistical study based on rather broad assumptions whose validity governs the reliability of the interpretation. As a by product of the method employed, the study emphasizes the importance of careful analysis of the component parts of governmental "spending"—broken down into a pattern of income payments to individuals—in considering the relation of the program of the government to the character of the private economy. In broad terms the interest and results of the study are definitely connected with current thinking on the forms of social and fiscal policy which will tend to further the economic welfare of the nation.

FRAMEWORK OF THE PROBLEM

A vital result of the impact of economic depression which gripped the United States at the end of the 1920's is the increasing importance of the role of government in the national economy. The attempt to adjust governmental action to the particular situation existant within the nation during the decade of the 1930's has necessitated the constant formulation and reformulation of the "problem" to be attacked. Diagnoses of the central fact of unemployed men and idle resources have run the gamut from "lack of confidence" to "an inherent weakness in the capitalistic system."

Without pronouncing judgment upon any of the proposed explanations of economic conditions, a series of related ideas, current in economic literature and discussion, may be presented which form the framework for the central problem of this paper.[1] Foremost among these is the notion of "governmental spending." There must obviously be a more concrete definition of this phrase. As used here it implies simply the execution of the decision of the political representatives of the people to spend money from the national treasury for any purpose whatsoever, financing such expenditure through taxation and borrowing. Governmental spending may be statistically defined in terms of objects of expenditure, the goods and services which the outlays call forth. The primary aim here is to plot the re-

[1] The few topics presented here are not intended to be an exclusive list. Because of their general nature no attempt has been made to document them.

sults of such spending upon income distribution. The many arguments for and against the efficiency of governmental expenditures will not be considered.

A second fundamental idea is found in the discussions of saving and investment. The relation between these factors may be considered from the standpoint of income distribution to reveal the degree to which consumption expenditures exhaust the total income of individuals within certain income classes and the possibilities for saving which exist within each income class.

A third idea adds to the facts of income distribution the proposition that outlets for investment open to individuals in the higher income classes have fallen to such a low point that the government is forced to undertake income generating activities in order to attain a higher level of employment and national income. The logic of these statements is followed out by proposals to further an investment phase of governmental fiscal policy through the exactment of a tax on savings and the encouragement of long range economic planning.

Alongside of these propositions which stem essentially from the assumption that the achievement of relative maturity in the economy forces the adoption of new social policies, the very fact of increased governmental spending has given rise to ideas which attack the long range values of the spending philosophy. These rest upon an analysis of the present economic system in which it is asserted that private enterprise—as definitely distinct from the political body sponsoring government spending—if given sufficient freedom can accomplish the difficult task of utilizing the now idle resources of the country. It is claimed that the continuance of a governmental spending policy, accompanied by increasing debt, threatens the ultimate credit of the nation. The statement that outlets for investment are lacking is ridiculed and the position taken which finds expression in a policy decidedly opposed to any measure which might accompany the entrance of government into a permanent investment program in competition with private enterprise.

A further factor of real importance in both the economic and political spheres is the general recognition of the economic insecurity of large portions of the population. This has found expression in the policies of the Roosevelt administration through the assumption by government of more "social serv-

ices." Implicit in this movement is the desire to extend both direct and indirect benefit to the lower economic classes. This desire is supported in the fields of social insurance and public assistance by purchasing-power doctrines which hold that large scale production can not effectively continue if it tends to choke off its own market through a diminution of employment.

Speaking in broad terms, the significant fact which provokes discussion in the field of fiscal policy is the role which government is playing in the national economy. The idea of an enlarged sphere of governmental activity is closely identified with its effect upon a spending program and this in turn deals intimately with the income structure of our society. The mere consideration of the problem of the role of government has provoked studies which have lent clarity to many of the features of the national economy.[2] The growth of the concept of the nation as an economic entity presents new areas within which to seek the solution of economic problems.[3] It is against this background that the attempt is made to show the shifts in income distribution during the period 1930-1939 which may be attributed to the taxation and expenditure policies of the national government.

THE CONCEPT—REDISTRIBUTION OF INCOME

Before presenting the results of the statistical study the particular meaning of redistribution of income and its relation to other studies may be noted. The writers of *Facing the Tax Problem*[4] make the distinction between a "change in distribution of income" resulting from governmental taxation and expenditures and "redistribution" proper. The former is a general term, including the latter, which may be said to accompany all public expenditures inasmuch as the benefits which an individual person receives from governmental expenditures rarely equal exactly his tax burden. Redistribution, however, "means taking from some and giving to others. . . . Frequently . . . the total income or wealth of some people is decreased by taxation while the total income or wealth of other people is increased

[2] For example, National Resources Committee, *The Structure of the American Economy*, (Washington, 1939).

[3] The growth of the notion of a "national labor market" as seen in the interpretation of the commerce power before the courts illustrates this in part.

[4] Twentieth Century Fund, *Facing the Tax Problem* (New York: The Twentieth Century Fund, 1937).

through the less vital functions of government. In this case, redistribution takes place. A similar process occurs in the payment of bonuses, pensions, doles, subsidies and interest and principal on debt."[5] If the income classes used in this study are substituted for the "some people" in the above quotation, the usage of the term redistribution here will be in line with that in the volume cited.[6]

Having set the problem as being the determination of the effect upon income distribution of the taxation and expenditures of the national government during the past ten years it is necessary to select a mode of procedure from among the several possibilities. Two main approaches are those which may be called the "pure monetary approach" and the "benefit approach." Under the former the attempt is made solely to trace the flow of revenues which draw funds out of the various income classes and of expenditures which contribute income to these same groups. Here the problem is mainly one of allocation as the figures on revenues and expenditure items are readily available from government reports.

The benefit approach is not primarily concerned with allocating money income to various groups but rather with charging the "cost" of certain services provided by the government to the group which they are intended to benefit. Thus the total cost of a program of work relief would be assigned to a low income group on the theory that it was primarily designed for their benefit. The contrast between this procedure and the pure monetary approach which would attempt to break down the expenditures involved in the work relief program on the basis of the income class into which they initially flow is apparent. One difficulty with the benefit approach lies in the fact that "cost" is still the measure of benefit although actual benefit may exceed or be less than cost. The assessment of benefit on any other terms, however, is as yet a relatively undeveloped field.

The study of Mr. Colin Clark, included in *National Income and Outlay*, illustrates the partial use of the benefit method as applied to governmental expenditures in England.[7] He notes at the outset that

[5] *Ibid*, p. 204.

[6] Some exception, however, might be taken to the use of the term "less vital" functions of government.

[7] Clark, Colin, *National Income and Outlay* (London, 1938). By permission of the Macmillan Company, publishers.

. . . one of the salient features of the distribution of income in recent times has been the high rate of progressive taxation falling upon the larger incomes, a considerable part of the proceeds of which are redistributed in the form of unemployment benefit, old age pensions and social services. On the other hand, we must not lose sight also of the high burden of indirect taxation, and the amount of public income which is redistributed in the form of interest on the National Debt, which largely goes to augment the higher incomes.[8]

Mr. Clark uses only two income groups in his study, drawing the line at £250. From simple assumptions as to the incidence of direct and diffuse taxes Mr. Clark derives the amount drawn from each of the two groups. Governmental services are then divided in the following manner. Unemployment benefits and assistance, war pensions, old age pensions, widows and orphans pensions, public assistance payments, health insurance payments, education payments, public health payments and housing payments are assigned to the benefit of the working classes. Interest on the national debt and payments for highways are assigned to the benefit of the "well-to-do." Mr. Clark then attempts to balance off tax payments from each group against the cost of the services designed for their benefit. On the basis of his estimates for the years 1913, 1925, and 1935, he concludes:

In 1913 it appears that the working classes contributed more than the cost of the services from which they were the direct beneficiaries, leaving a surplus contribution to general revenue. In 1925 working-class taxation contributed 85% of the cost of these specified beneficial expenditures; in 1935—79%. Between 1925 and 1935 working class taxation increased by 73 mil £ but expenditures in services beneficial for the working classes increased by 119 mil £.

The net effect of taxation and local rates in 1935 can be described as a redistribution of £ 91 mil from the rich to the poor in the form of services, other than those provided for from the proceeds of working-class taxation. The £ 685 mil paid by the rich in indirect and direct taxation provides £ 263 mils of services to themselves, £ 91 mils for transfer as above, and the whole cost (331 mils) of general administration and of public savings not covered by miscellaneous revenues.[9]

[8] *Ibid*, p. 134.
[9] *Ibid*, pp. 147–148.

In criticism of this result it might be stated that since the group described as "working-class" comprises 85 per cent of the population some part of the item "general administration" might be credited to their benefit which would increase the amount of the "transfer" payment. From a purchasing-power —income-distribution standpoint the general method of assigning the cost of a service to the benefit of one group may be criticized on the grounds that it fails to show adequately those portions of the expenditure for a service which go initially to other income groups.

Essentially Mr. Clark's study measures the extent to which the services provided by the government in England are financed by what might be called "benefit charges." Observations on the use of benefit charges in the United States have been made by Mabel Newcomer in the volume *Facing the Tax Problem*. Writing on the theory of benefit charges, she states that their use tends to "express an attitude that existing difference in wealth, income and opportunity shall be taken for granted. In other words, the distribution of wealth and income is not likely to be greatly changed if the government finances new activities on a benefit basis."[10]

There are three outstanding examples of the use of benefit charges by the federal government in the United States.[11] Most important is the operation of the postal service which runs without appreciable loss or gain depending mainly upon the amount of controversial items carried free of charge. Federal-aid payments for highways in the years 1933, 1934, and 1935 were slightly under the revenues received from the gasoline tax and the excises on oil, tires and tubes, and other accessories. The newest fields in which a type of benefit taxation has been applied are the contributory old age pension and unemployment compensation plans.[12] Miss Newcomer's study does not attempt an estimate of the amount of "transfer" expenditures from rich to poor as found in Clark's volume.

Turning from these studies as illustrative of the use of a benefit concept in assigning the incidence of expenditures, we may examine two studies bearing particularly upon the tax burden among different income groups. A method very close

[10] Twentieth Century Fund, *op. cit.*, p. 256.

[11] These illustrations drawn from the article by Mabel Newcomer as cited.

[12] It is interesting to note that the use of a payroll tax to finance unemployment insurance is now being seriously questioned.

to the one followed in this paper was used by Henry S. Dennison and associates in the volume *Toward Full Employment.*[13] Here general assumptions as to the incidence of federal taxes were adopted. On the basis of these assumptions applied to the best available data a series of "guesstimates" were reached.[14]

More exact estimates of tax burden on different income classes have been made by Mabel Newcomer.[15] The method followed has been the construction of a hypothetical family and the application of the prevailing tax rates in particular states to this standard. The consideration of state taxes makes necessary more definite assumptions (relating primarily to the property tax) than in a study which considers solely federal taxes.

In addition to the limited number of studies on phases of the distribution of governmental taxes and expenditures, comment is found in the literature of public finance upon the subject of redistribution itself. The point usually made is that the use of taxation as an instrument of redistribution, while permissible, must be limited by the prevailing social beliefs of the society. In short, redistribution is a "political matter." It is interesting to note at this time that classical economic theory maintained a direct relationship between the concentration of income, making savings possible, and economic progress; the benefits of such progress to be made available to large numbers of people through a reduction in prices. It would follow from these statements that too much redistribution would tend to decrease production. In contrast to this view is the modern school which attributes depression in part to the fact that because of the concentration of wealth, consumers goods are increased more rapidly than the ability of consumers to purchase them.

REDISTRIBUTION OF INCOME, 1930–1939

To facilitate the assignment of consumption taxes to income groups the income classes used in the Consumption Expendi-

[13] H. S. Dennison, L. Filene, R. E. Flanders, M. E. Leeds, *Toward Full Employment,* (New York: Whittlesey House, 1938).

[14] The authors explain the coining of this term. "Much of the information needed for exactness is either partly or completely lacking. But the question as to what, if any, taxes should be decreased or increased is a live and vital one. . . . Here, then, as in so many questions of business and of public policy alike, it is wiser to make such estimates as can be made, gauging where possible their range of error, than it is to go completely blind." p. 164.

[15] Twentieth Century Fund, *Studies in Current Tax Problems,* (New York: Twentieth Century Fund, 1937), "Estimate of the Tax Burden on Different Income Classes", pp. 1–52.

ture study of the National Resources Committee will be employed in this paper.[16] As that study was made for the year 1936 it is, of course, somewhat faulty to assume that the proportions noted in that year will hold throughout the decade. National income in 1936 was higher than the average for the decade. This should only tend, however, to make the results somewhat more conservative from the standpoint of the great inequalities in income distribution which existed during the period.[17]

Between July 1, 1929 and June 30, 1939 the federal government spent for all purposes a net total of 66.1 billion dollars.[18] During this same period revenues from taxation and holdings amounted to 39.7 billions. The public debt was increased from 16.185 billions to 40.361 billions so that roughly twenty-four billions or nearly 40 per cent of the money expended by the federal government came from private subscriptions to the public debt or through bank credit creations. The aggregate national income for this ten year period amounted to 565 billions of dollars.[19] Federal government expenditures may thus be seen as 12 per cent of the total for the ten year period considered as an aggregate.

Table 1 presents in summary form the results of the study. All government expenditures have been placed in one of the expenditure categories shown in Table 4, comprising a modified functional classification.[20] To reduce all expenditures to income figures it has been necessary to assign money spent for other than personal services to income groups. This has been done by adopting a definition of income similar to that found in a recent study of industrial income distribution.[21] Here it is assumed that all expenditures for materials and supplies become income at some stage in the form of salaries, wages, or a return on capital.

As shown in Table 1 the lowest income group, comprising the

[16] National Resources Committee, *Consumer Expenditures in the United States*, Estimates for 1935–36. (Washington, 1938).

[17] On the assumption that a smaller percentage of the population will be found in the lower income groups during 1936.

[18] Figures for governmental expenditures compiled from Reports of the Secretary of the Treasury, 1930–1939.

[19] Figures for national income those of the United States Department of Commerce as published in vol. I of T.N.E.C. reports.

[20] Inasmuch as miscellaneous expenditures and revenues have not been divided into income groups, Table 1 presents approximately 90 per cent of expenditures and 93 per cent of tax receipts.

[21] Spurgeon Bell, *Productivity, Wages and National Income*, (Washington: The Brookings Institution, 1940).

TABLE 1

AMOUNTS ADDED TO AND WITHDRAWN FROM SELECTED INCOME GROUPS BY GOVERNMENTAL EXPENDITURES AND TAX WITHDRAWALS; ESTIMATED EFFECTIVE TAX RATE AND PER CENT INCOME RECEIVED FROM GOVERNMENTAL PAYMENTS, IN SELECTED INCOME GROUPS, 1930-1939

(*figures in millions of dollars*)

Income Groups	Aggregate Tax Payments		Aggregate Income Received		Balance	Effective Tax Rate	% Income Received from Government to Total Income
		%		%		%	%
Under $780	$ 1,930.2	5.0	$15,923.4	26.8	$14,006.2	3.3	27.1
780–1450	4,592.1	12.1	7,947.7	13.4	3,355.6	3.4	5.9
1450–2000	3,545.2	9.7	6,992.0	11.8	3,396.8	3.7	7.3
2000–3000	4,985.0	13.4	10,923.6	18.4	5,938.6	4.9	10.8
3000–5000	3,611.0	9.8	4,825.0	8.1	1,214.0	5.7	7.6
5000–15,000	3,797.0	10.3	3,132.5	5.3	—664.5	6.8	5.6
Over 15,000	14,769.0	39.7	9,590.0	16.2	—7,179.0	27.1	17.3
	$37,229.5	100.0	$59,334.2	100.0			

Income Group	Balance Adjusted for Private Borrowing
$2000–3000	$5,188
3000–5000	214
5000–15,000	—1,914
Over 15,000	—14,179

one-third of the nation receiving $780 or below, received the greatest percentage of governmental expenditures while contributing the smallest percentage of tax revenues. This result follows naturally from the large expenditures for direct and work relief. Somewhat surprising is the high percentage of income received by the group between $2000 and $3000 together with the relatively high percentage of taxes taken from this group. As explained in a later section this result is due to the form of the various indexes used to assign income and tax payments.[22] The progressive nature of the tax system in the upper brackets is apparent from the high percentage of tax revenues drawn from the group over $15,000. The bulk of the income received by this group from governmental expenditures is in the form of payments and interest on the public debt.

Rigid adherence to a purely monetary approach demands the inclusion of money drawn from the various income classes in response to offerings of public certificates of indebtedness.[23] An adjustment to include these amounts gives added emphasis

[22] See below pp. 250ff.

[23] Figures based on the assumption that 40 per cent of the debt increase between 1930 and 1939 was subscribed by private individuals, insurance companies, mutual and savings banks.

to the sizable deficit balance found in the two highest income classes. It must be remembered, however, that these funds are offered mainly because of the investment advantages of government securities. The subscription of private individuals in the upper income brackets to large portions of public debt offerings has the same effect so far as distribution is concerned as the proposed tax on savings; with the important exception that the latter proposal would not involve future interest payments.

Table 1 also presents an estimate of the effective rate of federal taxation during the ten year period. To obtain this figure it was necessary to assume that the figures given in the National Resources Committee study for the percentage of national income received by each income group represented an approximate average figure for the decade. Applying these percentages to national income it is then possible to figure both the effective rate of taxation within each group and the importance of income received from government in total income receipts.

In the light of many statements concerning the regressive nature of our present tax system it may seem surprising that this trend is not reflected in the effective tax rate figures.[24] There are, however, several reasons which would justify these results. First, it must be remembered that the effect of local and state taxes is not considered here. Second is the fact that in three of the ten years, 1930, 1931 and 1932 the excise taxes which are the main regressive element in the federal tax structure were not a large proportion of the total. More convincing, however, is the index of consumption itself which indicates that the lowest groups do not account for enough of total consumption to make the tax regressive in the lowest brackets on absolute figures.[25] Using these figures alone, a regressive trend would be more noticeable between the second, third and fourth groups rather than in the lowest income bracket. Further in other studies which have indicated regression, the assumption is made that payroll taxes are shifted in total to the worker. While this may be the long run effect, incidence in the short run covered by this study is probably divided among profits, consumers and workers.

The influence of the use of aggregate figures is noticeable

[24] For example, that of Mabel Newcomer.
[25] See below, p. 259.

throughout and particularly in the column showing government income payments as a total of group income. In particular years the percentage of government contribution to incomes under $780 is larger than this aggregate-average figure.

COMPARISON OF THE YEARS 1929 AND 1936

Although Charts I and II considered in the light of the following assumptions give some indication of the trends in governmental taxation and expenditures, as translated into deductions from and payments to income groups, this may perhaps be more clearly shown by a direct comparison of the years 1929 and 1936.

In constructing the following tables an attempt has been made to adjust the income groups in 1929 so that they would contain the same proportions of population as the National Resource Committee figures for 1936. This was done by using the comparative data in Leven's *The Income Structure of the United States.*[26] It is open to the criticism, however, that population distribution might not conform exactly to income distribution in the two years considered.[27] For the year 1929 the expenditure data was taken from *America's Capacity to Consume.*[28] In distributing the taxes the same assumptions as to incidence have been followed for both 1929 and 1936. The same general assumptions have been followed with regard to the incidence of expenditures although the percentages within the respective indexes have been changed to conform to changed conditions.

Table 2 which compares the results for 1929 and 1936 reveals several interesting points. In terms of absolute aggregate tax payments the burden was heavier in 1936 than in 1929 in the lower brackets and lighter in the two top brackets despite increased tax rates. The estimated tax rates shown in Table 6, however, relate the aggregate figures to a percentage of total income within each income group. The great shift has come on

[26] Maurice Leven, *The Income Structure of the United States* (Washington: The Brookings Institution, 1938). Valuable comments on the comparability of the 1929 Brookings study and the National Resources Committee's study for 1935–36 are also found in Appendix II of the latter source.

[27] A further inaccuracy may have resulted from the method of adjusting the 1929 income groups. It was assumed that a straight line relationship characterized the distribution within each group.

[28] M. Leven, H. G. Moulton, C. Warburton, *America's Capacity to Consume* (Washington: The Brookings Institution, 1934).

TABLE 2

AMOUNTS ADDED TO AND WITHDRAWN FROM SELECTED INCOME GROUPS BY GOVERNMENTAL EXPENDITURES AND TAX WITHDRAWALS; ESTIMATED EFFECTIVE TAX RATE AND PER CENT INCOME RECEIVED FROM GOVERNMENTAL PAYMENTS, IN SELECTED INCOME GROUPS, 1929–1936

(*figures in millions of dollars*)

Income Groups	Aggregate Tax Payments	Aggregate Income Received	Balance	Effective Tax Rate %	% Income Received from Government to Total Income Received
		1929			
Under $1100	$ 161.6	$ 339.6	$ 178.0	2.37	5.00
1100–1750	330.5	545.2	215.2	3.04	5.01
1750–2500	289.7	737.4	447.7	2.35	5.98
2500–3750	379.3	349.9	—30.0	3.13	2.89
3750–7500	327.5	285.5	—42.0	2.33	2.03
7500–28,000	382.4	334.5	48.0	3.35	2.97
Over 28,000	1,659.0	858.8	—800.2	11.67	6.04
		1936			
Under $780	$ 221.5	$2,600.0	$2,378.5	3.35	39.39
780–1450	558.0	1,255.0	697.0	3.67	8.26
1450–2000	401.0	1,134.0	733.0	3.73	11.0
2000–3000	457.0	1,717.0	1,260.0	4.02	15.1
3000–5000	379.5	776.0	386.5	5.33	10.91
5000–15,000	380.5	461.0	80.5	6.05	7.33
Over 15,000	1,458.5	1,036.0	—422.5	23.42	16.64

the expenditure side of the ledger as seen in the figures for aggregate income received. Large governmental income payments have more than offset in all cases the increased tax burden.

Combining the incidence and expenditure figures it is possible to make rough calculations for the United States in 1929 and 1936 similar to those made in England by Colin Clark. Dividing the population into two groups at the $2500 mark it can be said that in 1929 the "working classes" contributed 781.3 million dollars. Expenditures of special benefit to this class consisted of 519.2 millions for war pensions. (To follow Mr. Clark's method it is necessary to assign the whole cost of a service to a particular group. On the basis of our income figures 416.5 millions dollars in war pension payments would be assigned to the groups under $2500.) Although none of the other specified items listed as benefits to the working classes were of major importance in 1929 we may say roughly that the working classes paid 781.3 million dollars and received 600 million dol-

lars in the form of special benefits. In the same year the "well-to-do" paid 2,747.2 millions. Items to their benefit include 1,203 millions in payments on the public debt.[29] Thus the regular departmental and army and navy expenses were met primarily from the contributions of the well-to-do plus a small "transfer" payment from the working classes.

In 1936 the situation is changed. Here, with the dividing line at $2000 the working classes contributed 1180.5 million dollars. Assuming the whole cost of public assistance payments, agricultural payments, war pensions, public works and housing payments to be for the benefit of this category we reach the grand total of 6,273 millions. This figure, however, is inflated both by the large bonus payments to veterans in that year and the method of assigning the total cost of the programs listed above to a particular group. The major part of the "transfer" payments which this year would run from the well-to-do to the working classes come from debt creation. The well-to-do contributed 2,675.5 million dollars, 1,108 million of which was returned in the form of debt payments. The remainder was not quite sufficient to meet the costs of the army and navy and regular departmental expenses. This analysis brings out clearly the primary importance of debt creation in 1936 as the main factor which accounts for the real swing in favor of the working classes.

ASSUMPTIONS GOVERNING THE INCIDENCE OF TAXATION

An analysis of federal receipts other than borrowing for the ten year period 1930–1939 reveals the following main sources of revenue.

TABLE 3

AGGREGATE RECEIPTS OF THE FEDERAL GOVERNMENT OTHER THAN BORROWING 1930-1939

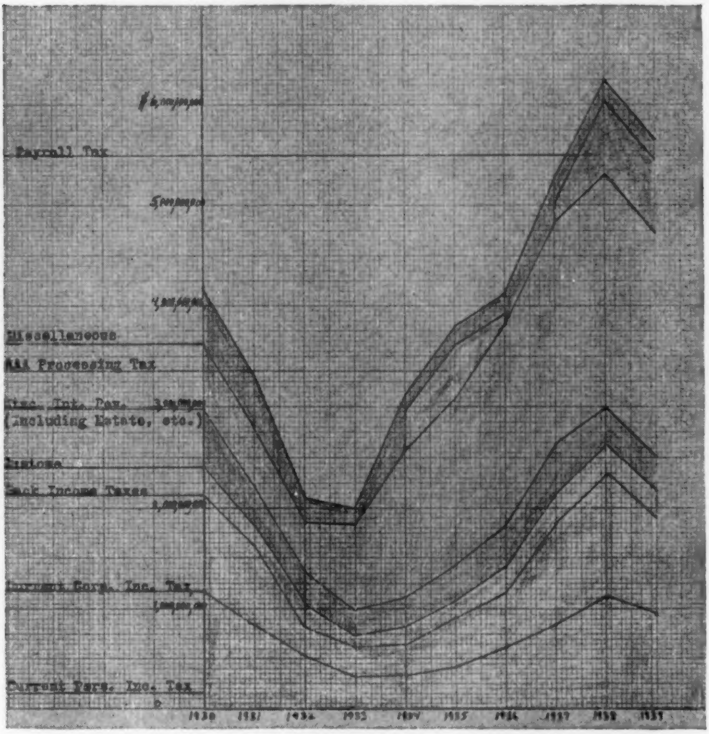
Tax	Millions of Dollars	Per Cent of Total
Income Tax	$16,288.5	40.8
Corporate $8,290.5		
Personal 7,998.0		
Misc. Internal Revenue	11,581.7	29.0
Customs	3,751.0	9.4
Estate, Gift, Capital Stock	2,954.0	7.4
Payroll Tax	1,754.8	4.4
A.A.A. Processing Tax	951.2	2.4
Miscellaneous	2,649.9	6.6
Total	$39,931.1	100.0

[29] Including a sinking fund payment.

The following chart depicts the cyclical changes in the various amounts of each of these sources of revenue. For the purposes of this section, however, only the aggregate sums for the ten-year period combined are used.

CHART I

REVENUES OF THE FEDERAL GOVERNMENT 1930–1939



Source: *Annual Reports of the Secretary of the Treasury;* 1930–1939.

Personal Income Tax

It is generally agreed that the incidence of the personal income tax rests upon the person paying the tax and is not shifted.[30] Adopting this assumption and using figures from the

[30] The following have been used to obtain a "general" viewpoint on incidence: H. L. Lutz, *Public Finance*, (New York: Appleton-Century, 1936), 3rd Edition;

Statistics of Income[31] for the years 1935 and 1937 the revenues derived from the personal income tax may be allocated to the stated income classes. Inasmuch as figures in *Statistics of Income* are "net" while the stated income classes represent "gross" figures an additional adjustment must be made. It has been assumed that an adjustment of $2500, representing a reasonable exemption deduction for individuals with incomes from $3000 to $7000, will bring the gross income figures of our income classes into line with the net income figures of *Statistics of Income.*

Corporate Income Tax

The incidence of the corporate income tax is generally held to fall on the owners, stockholders, or dividend recipients of the corporation. The two studies to which reference is usually made to substantiate this view are now distinctly out of date.[32] There is ample room to doubt the validity of an assumption which places the whole burden of the tax upon "profits." With the tax at its present level some portion of it might conceivably be shifted to the consumer, particularly in those industries which enjoy a monopolistic position. However, the safest single assumption is still that of a 100 per cent burden upon owners. Accordingly, an index has been constructed on the basis of dividend distribution figures found in various studies. This index is only a "guesstimate," however, as the detail on dividend distribution for net income groups under $5000 during any year of the 1930's is largely lacking. The index used here represents an adjustment of the Berle and Means index for 1929[33] on the basis of figures from the *Statistics of Income* which give an estimate of the per cent of all dividends received by those in net income classes of $5000 and above.

A. G. Buehler, *Public Finance* (New York: McGraw-Hill, 1936), 1st Edition; H. M. Groves, *Financing Government* (New York: H. Holt and Co. 1939), E. R. A. Seligman, *The Shifting and Incidence of Taxation* (New York: Columbia University Press, 1932), 5th Edition.

[31] United States Treasury Department, *Statistics of Income* (Washington).

[32] In the sense that the tax has so changed as to alter the problem. The studies referred to are: National Industrial Conference Board, *The Shifting and Effects of the Federal Corporate Income Tax* (New York, 1928)—also, Report of the Colwyn Committee in Great Britain, 1927.

[33] A. A. Berle, and G. Means, *The Modern Corporation and Private Property* (1933). These figures are quoted in E. D. Kennedy, *Dividends to Pay*, (New York: Reynal and Hitchcock, 1939).

Miscellaneous Internal Revenue

In attempting to assign internal revenue excises to income groups it is assumed that the full amount of the tax is passed on to the consumer. Inasmuch as 84 per cent of the revenue in this classification is derived from taxes on tobacco, liquor and gasoline (including oil and automobile accessories) this assumption seems justified because of the tendency to add additional taxes to the cost of such products. On the basis of the consumption figures presented in the National Resources Committee study showing both the portion of total consumption assignable to each income group and the percentage of that total spent for particular products by each income group an index was constructed weighting the various factors.[34]

Customs Duties

The assumption of full incidence upon the consumer is also made in assigning the revenue from customs duties. Here again the use of a single assumption is probably an oversimplification but it is not one which should lead to great error in the assignment of customs revenues. As the large proportions of customs duties are derived from a more diverse range of products than the internal revenue taxes an index which conforms more closely to the general index of consumption among the income groups has been used.

Estate, (etc.) Taxes

The difficulty of estimating the incidence of the estate, gift, capital stock, and transfer tax is increased by the fact that no precise figures are available for translating size of estates into yearly income figures.[35] In terms of our income classes, however, the problem is simplified by the relatively small lower limit of the highest category as contrasted with the large exemption allowances under the estate and gift taxes. The inclusion of the capital stock and excess profits tax in this category (comprising 25 per cent of the total) necessitates the

[34] The various indexes used in the assignment of income are found on pages 258 and 259.

[35] H. L. Lutz, *The Fiscal and Economic Aspects of the Taxation of Public Securities* (New York: Bar Press, 1938), p. 221–2. Mr. Lutz converts estates into net income groups on the assumption that annual net income is "approximately 3 per cent or thereabouts" of the value of the estate. I have not used this figure in computing the incidence of the estate tax as I consider it too low a percentage.

assignment of some incidence on a scale approximating that used for the corporate income tax. Thus the governing assumptions are: a) 75 per cent of the total assigned, 90 per cent to the group over $15,000 and 10 per cent to the group between $5000 and $15,000; b) 25 per cent of the total assigned on the corporate income index.

Payroll Tax

A number of articles have considered the incidence of the payroll tax and its use in financing part of the social security program.[36] This study includes tax collections from that source in the four years 1936–1939. This is without question the "short-run phase" and our assignment of incidence must be made on that basis. Starting from the assumption that because of a sparsity of information the best procedure would be to assign equal thirds to profits, consumers and wages—a downward adjustment was made in the case of consumers. This adjustment reflects the trend in price levels which were not favorable to forward shifting of the tax, particularly during 1937 and 1938. Thus 25 per cent of the tax is assigned on the basis of general consumption; 37.5 per cent on the corporate income index (representing incidence on "profits"); and 37.5 per cent on a wages and salaries index.

A.A.A. Processing Tax

The incidence of the processing tax levied under the Agricultural Adjustment Act presents another area in which "guesstimates" must be liberally used. Some statistics are available particularly in Grove's *Financing Government* and the Brookings Study, *Three Years of the A.A.A.*[37] Main reliance for this paper has been placed upon a private study which found that in the case of an individual firm whose opportunities for shifting were near the average, 80 per cent was shifted forward to consumers.[38] The assumption made here is that 30 per cent rests on profits and 70 per cent is shifted to consumers. A further calculation was made assuming some backward shifting to pro-

[36] James K. Hall, "Incidence of Federal Social Security Pay Roll Taxes," *Quarterly Journal of Economics*, vol. LIII, No. 1, Nov., 1938.
[37] E. G. Nourse, J. S. Davis, and J. D. Black, *Three Years of the A.A.A.* (Washington: The Brookings Institution, 1937).
[38] Study conducted for the "denim cotton group" under the direction of E. S. Mason.

ducers which did not significantly alter the results derived from the assumptions stated above.

Miscellaneous

No attempt has been made to assign the items included in this category to various income groups. Income from trust funds and domestic and foreign obligations make up the major portion of this total. As noted in the earlier tables, the amount of such miscellaneous revenues is deducted from total revenues during the period.

The amount of tax incidence assigned to each income group under the foregoing assumptions is presented in Table 4. It may be noted that in some instances the probable error in certain of these assumptions tends to cancel out in the final result. Thus if the results stemming from the assumption that the whole amount of corporate income tax rests on "owners" errs by failing to assign a portion of that tax to consumers this may in part be balanced by the assumption that 100 per cent of customs duties and the larger share of processing taxes rest upon consumption. The main error is probably caused by using a rigid index for the ten year period.

ASSUMPTIONS GOVERNING THE ASSIGNMENT OF INCOME

Drafts on the federal treasury are paid out for three major purposes. First, and easiest to trace in terms of income groups, are payments for personal services to federal employees and others directly connected with the operation of the government (including members of the army, navy and air corps). Another large body of federal income recipients are those who receive direct payments not for a present service rendered, but by virtue of contractual obligations or of their inclusion in a special-aid group. In this category are the persons receiving federal interest payments, the pension recipients and the large numbers receiving federal direct and work relief. Finally, payments are made for the large amount of supplies and materials which must be purchased to carry on the many activities of government. To translate these payments into receipts for our established income groups it is necessary to allocate them in terms of a breakdown into salaries, wages, and returns on capital.

TABLE 4

ESTIMATED TAX WITHDRAWALS SHOWN AS PERCENTAGES OF TOTAL TAX WITHDRAWALS FROM SELECTED INCOME GROUPS, 1930–1939

(figures in millions of dollars)

Income Groups	Personal Income Tax		Corporate Income Tax		Estate Tax		Customs		Miscellaneous Internal Revenue		A.A.A.		Payroll Tax	
		%		%		%		%		%		%		%
Under $780	0	0	0	0	0	0	525	27.2	1158	60	93	4.8	153	7.8
780–1450	0	0	0	0	0	0	1050	22.9	3127	68.1	186	4	228	5.0
1450–2000	0	0	479	13	44	1.2	675	19	1968	55	119	3.1	307	8.7
2000–3000	0	0	1199	24.05	100	2.0	675	13.54	2548	51.11	179	3.6	282	5.7
3000–5000	248	6.86	1199	33.2	110	30.4	375	10.38	1389	38.46	109	3.09	177	4.97
5000–15,000	1160	30.55	959	25.25	321	8.5	262	6.9	810	21.33	80	2.1	201	5.29
Over 15,000	6880	46.58	4159	28.16	2378	16.19	187	1.2	579	3.92	182	1.23	403	2.72
	8288		7995		2953		3749		11579		948		1751	

In all of the following sections the method of procedure has been to make a rough estimate of the division of expenditures between personal services and supplies and materials. Income indexes have been constructed for federal administrative personnel, army and navy personnel, recipients of veteran's pensions, recipients of farm benefit payments and recipients of relief payments. The payments for supplies and materials are distributed on the basis of an "industrial index."[39] This index was constructed from a variety of reports, primarily the industrial income distribution figures published by the National Industrial Conference Board; the Brookings Institution study, *Productivity, Wages and National Income;*[40] and the wage reports in selected industries published by the United States Bureau of Labor Statistics.[41]

The classification of federal expenditures over the last ten years is made difficult by the many changes found in official sources and the changing character of "emergency" and "regular" expenditures. The classification in Table 6 follows the general pattern of the reports of the Secretary of the Treasury for the years 1935–1937. It is, however, entirely a "composite" chart and does not follow any prepared statement of expenditures.

Chart II depicts the cyclical changes in the various amounts of each of these categories of expenditure. For the purposes of this section, however, only the aggregate sums for the ten year period are used.

Regular Departmental

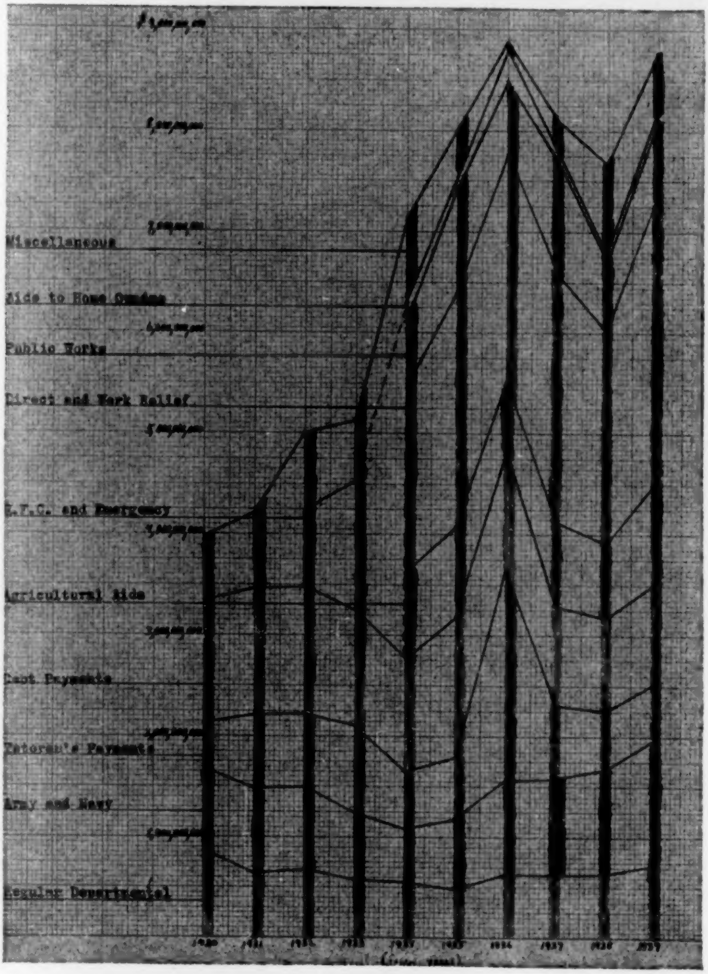
The category "regular departmental," included in many attempts to classify federal expenditures, is in some ways an attempt to isolate the "necessary" and "essential" governmental services from those which were added under conditions

[39] See below p. 258.

[40] National Industrial Conference Board, *Studies in Enterprise and Social Progress* (New York, 1939).

[41] United States Department of Labor, *Monthly Labor Review*, June, 1937, p. 1530, "Distribution of Male Wage Earners in Iron and Steel Industry According to Annual Earnings, 1934." Dec., 1938, p. 1398, "Percentage Distribution of Navy Yard Employees According to Annual Earnings in Yards Covered in 1935." July, 1939, p. 170, "Percentage Distribution of Workers in Radio Manufacturing, According to Annual Earnings, 1936." Oct., 1939, p. 924, "Percentage Distribution of Workers in Electric Manufacturing, According to Annual Earnings, 1936.) Dec., 1939, p. 1472, "Percentage Distribution of Meat Packing Workers by Annual Earnings, 1937." Jan., 1940, p. 176, "Percentage Distribution of Full Fitted

CHART II
EXPENDITURES OF THE FEDERAL GOVERNMENT 1930–1939



of "emergency." As such the starting point becomes the expenditures for the normal years from 1925–1932. From the total are eliminated the items for national defense (army and navy plus veterans), debt service and certain miscellaneous payments, leaving a figure comparable to what Colin Clark called the cost of "general administration."

TABLE 5

AGGREGATE CLASSIFICATION OF THE EXPENDITURES OF THE FEDERAL GOVERNMENT, 1930–1939

(figures in millions of dollars)

Regular Departmental	$ 6,501.9
Army and Navy	8,531.6
Veteran's Payments	8,638.0
Debt Payments	11,084.2
Agricultural Aid	4,995.5
Direct and Work Relief	13,881.2
Public Works	5,026.1
Aids to Home Owners	676.2
Miscellaneous	6,951.0
	$66,285.7

From an examination of the budgets of 1935 and 1938 for a representative group of "regular departmental" bureaus it was estimated that 65 per cent of the expenditures in this category are for personal services; 35 per cent for materials and supplies. The figures corresponding to these percentages were accordingly allocated to the various income groups on the basis of their respective indexes.

Army and Navy

The distribution of expenditures made for the army and navy as between personal services and supplies varies mainly with extensiveness of an armament program. Thus, for the year 1940–41 undoubtedly a major portion of the appropriation will go for materials and supplies. During most of the 30's, however, the rate of expansion was such that appropriations can be roughly divided between personal services and materials and supplies. The distribution figures in the tables of this

Hosiery Workers by Annual Earnings, 1937." Feb., 1940, p. 404, "Percentage Distribution of Knitted Underwear Workers According to Annual Earnings, 1937." Aug. 1939, p. 408, "Percentage Distribution of Employees Under Old Age Insurance by Classified Taxable Earnings, Sex and Race, 1937." (These last named tables include 93 per cent of the total volume of taxable wages reported as paid in 1937.)

paper have been computed on that basis. The budgetary figures for 1933, 1935, and 1938 substantiate the approximate validity of such an assumption.

Veteran's Payments

In the classification used here, the administrative expenses of the Veteran's Bureau and certain hospitals are contained within this category. Thus the amount actually distributed on the basis of the index of income of veterans amounts to 85 per cent of the total. The index of income distribution of veterans as a class is decidedly a "guesstimate." As may be seen by a comparison with the index for governmental administrative employees the index for veterans follows the former closely except for a slight weighting of the higher brackets. The weighting in favor of the higher brackets was made on the assumption that the present age of the veteran group would favor some increase in their earning power.

Debt Payments

Although it is generally assumed that payments on the national debt go into the pockets of the well-to-do, no study was found of the holders of the public debt classified on the basis of income groups. In 1938 approximately 19 per cent of the debt was held by individuals.[42] Private corporations, insurance companies and mutual savings banks held another 25 per cent. Insured commercial banks and federal reserve banks held 40 per cent while federal agencies and trust funds held 11 per cent. These figures are listed to show that the task of assigning the interest payments to income groups involves an assumption as to the manner in which payments to the institutions which hold the obligations reach individual recipients. Bearing in mind the index of dividend distribution plus the fact that tax-exemption features of government securities may attract wealthier purchasers a "guesstimate" has been made as follows: 70 per cent to group over $15,000; 12.5 per cent to the group between $5,000 and $15,000; 10 per cent to the group between $3,000 and $5,000; and 7.5 per cent to the group between $2,000 and $3,000.

[42] Reports of the Proceedings before the Temporary National Economic Committee, vol. III, p. 558, May 24, 1939. Source: United States Treasury Department.

Agricultural Aid

The expenditures in this category are primarily those made under the A.A.A. and Soil Conservation programs plus some direct agricultural relief. From an examination of the budget for these programs in 1936, 1937, and 1938 it was estimated that the breakdown should be as follows: 60 per cent for farmers benefits, to be distributed on the basis of statistics of farm income distribution; 20 per cent for materials and supplies to be distributed on the basis of that index; and 20 per cent for administrative expenses to be distributed on the federal administrative personnel index. The index of farm income distribution was taken from the N.R.C. study. This table was adjusted upwards slightly on the assumption that, particularly in the early days of the program, the middle and upper class farmers were in a better position to receive cash benefits.[43]

Direct and Work Relief

The issuance of a recent report by the Secretary of the Treasury on the status of funds appropriated under the Emergency Relief Appropriation Acts of 1935–1939 makes it possible to "guesstimate" a breakdown of the large total in this category.[44] The assignment of funds to income groups has been based on the assumption that the breakdown of those funds, comprising 85 per cent of the total, extends to the total. A further assumption has been made relative to the amounts granted to state and local governments for relief purposes; namely, that those amounts are then distributed in terms of relief payments and payments for supplies and materials, in the same proportion as the larger federal sum. On this basis 16 per cent is distributed on the supplies and materials index; 4 per cent represents rents and land acquisition on the business income index; and 80 per cent is distributed as relief payments. (10 per cent of this latter amount, however, is distributed on the federal administrative personnel index and considered as administrative expense.)

Public Works

The major items in this category are public highways (32 per cent), public buildings and defense (28 per cent), river and

[43] United States Department of Agriculture, *A.A.A. 1938* (Washington, 1939).

[44] Report of the President to Congress Showing the Status of Funds and Operations Under the Emergency Relief Appropriation Acts of 1935, 1936, 1937, 1938, and 1939, as of Dec. 31, 1939. (Washington, 1940).

harbor expenditures (18 per cent), and grants to local government units (16 per cent). Because of the mixture of "regular" and "emergency" projects undertaken within these headings it is difficult to make an assumption concerning the amount of relief expenditure involved. Generally speaking the employment of relief labor on this type of project, while not compulsory, was often forced by local policy. In view of the mixed character of these items, the total for this category has been divided into four parts. 10 per cent is apportioned on the index for federal administrative personnel; 10 per cent is apportioned on the "supervisory" index; 15 per cent is apportioned as relief and 65 per cent on the basis of the industrial index for materials and supplies. Some basis for this last figure is found in the budget estimates for the Bureau of Public Roads and public building figures.

Aids to Home Owners

The breakdown of this category, constituting but 1 per cent of the total, is also largely a "guesstimate." 50 per cent of the total consists of payments under the home loan system while 22 per cent consists of payments under the resettlement administration which border on relief payments. On the assumption that in most cases it has been the small home owner who has taken advantage of these federal programs a special index for home loan payments has been constructed. 14 per cent of the total is allocated to federal administrative personnel, 16 per cent to relief payments and 70 per cent on the basis of the home loan index.

Miscellaneous

No attempt has been made to allocate approximately 10 per cent of federal expenditures to particular income classes. This amount includes payments charged to the postal deficiency, tax refunds and trust fund obligations. Thus Table 1, showing the balance between federal income payments and tax withdrawals, really contains only 90 per cent plus of each.

The mere listing of the assumptions upon which the figures showing the amount of redistribution are based should in itself serve as a warning against their consideration as anything but "guesstimates."

TABLE 6

ESTIMATED GOVERNMENT INCOME PAYMENTS SHOWN AS PERCENTAGES OF TOTAL INCOME PAYMENTS TO SELECTED INCOME GROUPS, 1930–1939

(figures in millions of dollars)

Income Groups	Regular Departmental		Army and Navy		Veterans		Debt Payments	
		%		%		%		%
Under $780	792	4.97	1279.8	8.03	705	4.45	0	0
780–1450	1404	17.66	1748	21.99	1800	22.65	0	0
1450–2000	1386	19.82	1750.1	25.03	1840	26.31	0	0
2000–3000	1886	17.26	2317.2	21.21	2600	23.80	831	7.60
3000–5000	722	14.96	601.1	12.45	1120	23.21	1109.2	22.98
5000–15,000	216	6.99	298.5	9.94	573	18.88	1385	44.20
Over 15,000	86.2	.89	537.1	5.6	0	0	7759	80.9

Income Groups	Agricultural Aid		Direct and Work Relief		Public Works		Aids to Home Owners	
		%		%		%		%
Under $780	1178.9	7.40	10,400	65.31	1445.5	9.07	123	.77
780–1450	1718.2	21.63	444	5.5	743	9.34	90.5	1.14
1450–2000	784.2	11.24	466	6.66	649.7	9.29	116	1.65
2000–3000	810.7	7.46	1,157.2	10.59	1150	10.52	171	1.56
3000–5000	269.7	5.58	460	9.57	415.1	8.60	128	2.65
5000–15,000	104	3.42	289	9.22	220	7.02	47	.33
Over 15,000	129.8	1.35	665	6.93	402.8	4.33	.5	—

LIST OF INDEXES (1) [45]

FOR DISTRIBUTION OF INCOME PAYMENTS

Income Group	Federal Administrative Personnel	Veterans	Army and Navy	Industrial Index	Farm Benefits
	%	%	%	%	%
Under $780	8	8	10	20	30
780–1450	23	21	22	19	45
1450–2000	25	21	27	14.5	13
2000–3000	33	30	33	21	9
3000–5000	13	13	6	8	2
5000–15,000	2.5	7	2	5	1
Over 15,000	.5			12.5	

(Industrial index, used as breakdown for "materials and supplies" is made up from separate indexes for wages, supervisory wages and salaries, and returns on capital.)

[45] The index for federal administrative personnel is constructed from figures given in Mosher and Kingsley, *Public Personnel*, p. 390. The general construction of the remaining indexes has been indicated in the text. The index for army and navy payments was constructed partially from figures included in the budget and partially from correspondence with army and navy officers.

Income Group	Wages	Supervisory Wages	Returns on Capital
	%	%	%
Under $780	35	0	0
780–1450	33	2	0
1450–2000	20	10	6
2000–3000	10	60	15
3000–5000	2	18	15
5000–15,000	0	10	12
Over 15,000			52

(For studies from which wage and supervisory wage indexes were compiled, see notes.)

LIST OF INDEXES (2)

For Distribution of Tax Burden

Income Group	Personal Income Tax	Corporate Income Tax	Miscellaneous Internal Revenue	Customs
	%	%	%	%
Under $780	0	0	10	14
780–1450	0	0	27	28
1450–2000	0	6	17	18
2000–3000	0	15	22	18
3000–5000	3	15	12	10
5000–15,000	14	12	7	7
Over 15,000	83	52	5	5

(The three indexes listed on the preceding page for wages, supervisory wages and returns on capital were also used for calculating the distribution of taxes.)

National Resources Committee Indexes

Income Group	Per Cent of Total Consumption	Per Cent of National Income	Per Cent of Population
Under $780	14.4	10.4	33.3
780–1450	27.7	23.9	33.3
1450–2000	18.3	16.9	15.2
2000–3000	18.0	17.9	11.2
3000–5000	10.2	11.2	4.6
5000–15,000	7.0	9.9	1.9
Over 15,000	4.4	9.8	.5

CONCLUSIONS

Because of the highly "assumptive" nature of the results shown primarily in Tables 1 and 2, no attempt has been made to comment fully upon their significance. Nevertheless, assuming for the sake of formulating concluding observations that the figures are reasonably accurate, what do they show concerning the question of redistribution? One thing is apparent, that there has been, during the ten year period, a considerable redistribution of income brought about through the expenditures and tax withdrawals of the federal government. It is interesting to note that the aggregate of the excess of income payments over tax withdrawals in the first five income groups is nearly equal to the amount of federal borrowing during the period. Thus the borrowing process of the government, as should be expected, has increased the income, from a purely monetary standpoint of most income classes. This is not to say that the borrowing policy maximized their income or that some other form of governmental policy might not have produced more desirable results. Realistically, this result was implicit in our assumption that all governmental payments become income for someone in the economy. On this basis the results merely attest to the fact that the program followed produced the changes which have been noted.

The dynamic element in governmental finance during the decade of the 1930's has been expenditures for both direct and work relief. In this program the mechanism of redistribution has been direct. Taxes or borrowings have been withdrawn from one group and deposited within another group not so much through the mechanism of private industry as through a direct operation, involving coöperation with state or local agencies. The payments to higher income groups have been both of an indirect nature through the purchase of supplies, and direct through the payment of interest on the public debt.

The dynamic element in governmental finance during the decade of the 1940's seems destined to be the provision of funds for national defense. Here the mechanism of redistribution is somewhat reversed. The worker drawn off of the WPA roll to a position in private industry made possible by the expansion of national defense industries now receives his wage through the mechanism of private industry although the plant expan-

sion may have been financed, the orders placed and the product purchased by the federal government. Unless major adjustments in the tax program are made, and assuming a decrease in expenditures for work relief, real changes in the distributive effect of federal expenditures in favor of income groups above the $1450 level should result.

HOW GOVERNMENT BUYS: AN APPRAISAL

Albert M. Freiberg

FOREWORD

An all-pervasive question in public administration has to do with the extent to which the principles and methods of private administration are adaptable to public purposes. Too often are inarticulate major premises indulged in which lead to the direct transfer of the thinking of business to government problems or, on the other hand, the rejection of business experience as something belonging to a world foreign to that of the public administrator. A sane philosophy seems to call for a careful examination of the facts as they have developed in specific fields of public and private enterprise. The field of purchasing furnishes an excellent place for beginning such a study. It is perhaps a better starting point than comparative personnel studies, because the contrast between the methods by which business builds up its personnel and those by which governments proceed has been artificially heightened, on the one hand by civil service and on the other by the party spoils system. In the acquisition of materials, however, our thinking, if not our practice, has progressed beyond the spoils system. Furthermore, the tests of fitness and efficiency are more objective than in the case of personnel.

In the following pages Mr. Freiberg presents the results of a study made by him, as a member of the seminar in Public Contracts, of the peculiarities of government purchasing as they have developed to this day under a complicated mass of statutes, administrative orders and practices. He has approached the problem from the point of view of the business man who is accustomed to sell his wares to various types of private purchasers, including large industrial buyers, and who because of the increasing proportions of governmental business is now confronted with the necessity of readjusting his methods to take cognizance of the peculiarities of government purchasing.

Several causes contribute to these differences. Some of them are no doubt connected with the mere size of government orders and of the organization behind them. Many differences, however, are traceable to other peculiarities of government, such as its lack of the profit motive and its obligation to consider the welfare of its people and to maintain a fair attitude towards competing groups. Whatever the causes, the actual departures from familiar business routines called for when a government is the customer, are impressive. The techniques of fancy dress for goods, attractive naming, persuasive advertising, secret recipes (feigned or real), and much that goes under the name of goodwill, fall to the ground under the pressure of rigid specifications. Price-structures

give place to bidding. Salesmanship gives way to other arts and techniques. Credit practices are topsy turvy: it is the seller who must demonstrate his financial ability. The buyer's scrutiny may take on the form of controlling the conditions of production, the sources of materials, the labor terms. Before one can take a step towards seeking principles of conduct in all this, much more before he can criticize intelligently, he must collect the details of public purchasing and arrange them in something of the manner attempted here.

That a time for criticism rather than the servile imitation of precedents comes occasionally is illustrated in the present emergency. The "negotiated contract" has emerged in the National Defense program to take its place beside the highly standardized and circumscribed governmental contract of normal times. Obviously, excessive rigidity is the price paid for the protection that modern government purchasing laws afford against graft and favoritism. There may be times when this price is too high. The present study contains much of the essential material for such a critical appraisal. Of course it is typical rather than exhaustive. It sets forth the sort of thing that the vendor today must look for, rather than a definitive list of what he will find.

NATHAN ISAACS

THERE is no way of estimating the quantity of goods and services purchased by governmental bodies in the United States. However, we may say at least that the amount is very large indeed. In the fiscal year ending June 30, 1938, the office of the Supervising Engineer of the Treasury Department of the federal government drafted 518 formal contracts for construction work varying in amount from $2,000 to several million dollars each, the total original amount of these contracts being $39,553,286.[1] During the fiscal year of 1938 the purchases of the Branch of Supply of the Procurement Division amounted to $20,089,807, compared with $16,975,876 in 1936 and $27,762,952 in 1937.[2] It is difficult to say exactly how much the federal government spends on *materials*.

The Department of Purchase of the City of New York spent money for goods as follows: 1938, $26,640,542.86; 1937, $29,-089,104.34; 1936, $24,597,388.64.[3] Los Angeles County bought in one year $11,014,502.64 worth of goods.[4]

[1] *Annual Report of the Secretary of the Treasury, Fiscal year ended June 30, 1938*, p. 195.

[2] *Ibid*, p. 199.

[3] Report to Mayor La Guardia on the work of Department of Purchase City of New York for the year 1938, Russell Forbes, Commissioner, August 1, 1939.

[4] Survey Report of the Purchasing and Stores Department, October 1, 1937, p. 28.

I. PROBLEMS GENERAL TO ALL VENDORS TO GOVERNMENT

Production

Generally, public purchasers buy by specification, rather than by brand; in this respect they are similar to the large industrial buyers. Therefore, if a manufacturer has spent a great deal of money in popularizing his brand name, this money is wasted as far as government purchasing is concerned. Unlike middlemen, the public purchaser tends to ignore consumer preference. On the other hand, smaller governmental units, may be affected by goodwill in their purchases as are private consumers. But generally consumer goodwill which has been acquired at great expense will not make it possible for the vendor to get a higher price from the government.

When the highest possible quality is of the essence, the government tends (as in the case of flares for the U. S. Army Air Corps) to do its own manufacturing. In other cases, the public purchaser tends to specify the minimum quality which will meet his requirements. These requirements may be considerably below ordinary consumer standards. In such a case the manufacturer may be, in effect, penalized for his high standards.

It is characteristic of governments that they are not reliable customers. If the administration is honest, it tends to be a price buyer; that is, it calls for bids and takes the lowest. This is good from one point of view; but from the businessman's angle, there is no assurance of getting repeat orders. Government orders, if consolidated, as they are likely to be under an honest and efficient administration, are likely to be large; therefore, it is often difficult for the small manufacturer to take business which will occupy a large part of his plant and which he has no assurance of retaining. On the other hand, if the governmental unit is dishonestly or inefficiently run, the public purchaser is a reliable customer, at least for the time being. "Reliable," however, does not mean "desirable." Political parties change; and with new parties come not merely changes in methods: they also conduct investigations, etc. Therefore, we may conclude that it is best for the businessman to be flexible in relation to governmental customers: it is unwise to rely on sales to an individual governmental unit to provide a large percentage of total sales.

Sectionalism plays a large part in government purchasing.[5] As applied to the federal government, this is in compliance with a statute[6] which requires governmental buyers to use goods which are made in America primarily from American raw materials, unless they are not procurable at a reasonable price. States often go further whether by statute, as in Massachusetts,[7] or by administrative custom, and give a preference to goods made in the state, "other considerations being equal." A similar tendency may be found in cities, that "Brownville should buy Brownville-made goods." This inclination is becoming more widespread.

The Law

Government purchasing is hedged about with legal requirements not generally found in business. For example, most public purchasers are required by law to buy on the basis of competitive bidding, often from "the lowest and best bidder." Where this phrase is used in the statute or other law, the public purchaser has a good deal of freedom to compose private blacklists. On the other hand, it is not unusual for a law to provide that the government *must* purchase from the low bidder, and that the contractor must post a faithful performance bond. This sort of thing, as has been remarked, makes a lasting relationship between buyer and seller all but impossible.

A businessman who is used to dealing only with private corporations is not accustomed to worrying about the authority of the purchasing officer. If there is apparent authority, the vendor has a valid contract. This is not true with public purchasers; the vendor is put on notice to discover the *actual* authority of the person with whom he is dealing.

Other legal requirements will be discussed below, as they affect the several levels of government.

Information

One of the most difficult problems of the vendor is to find out what the public desires to purchase. There are three methods:

[5] See: *State Trade Walls*, by F. E. Melder, Public Affairs Pamphlets no. 37, November, 1939.

[6] 41 U.S.C. 10a.

[7] "A preference in the purchase of supplies and materials, other considerations being equal, in favor, first of supplies and materials manufactured and sold within the Commonwealth, and second, of supplies and materials manufactured and sold elsewhere within the United States." Mass. G. L. C. 7, Sec. 22 (17).

(1) Some public purchasers have mailing lists of contractors to whom they send invitations to bid. In such a case, the problem for the businessman is to discover what lists to get on. (2) Official advertising. This and the first method will be discussed at greater length below. (3) Personal contact.

Payment

It is often put forward as an advantage of selling to government that the credit risks are good; and that, in any case, the supplier is apt to get paid, no matter what happens to the bondholder subsequently. That is quite true; however, it paints the picture in colors a little too bright. In the first place, it often subsequently appears that one's contract is invalid, and this must often be tested by an expensive lawsuit. In the second place arbitrary delays in payment often occur. In the third place, many governmental units arbitrarily pay late and still take discounts for prompt payment.[8]

Politics

How the vendor stands politically may mean very much or very little, depending on the unit one is dealing with. Personal or political standing with those who frame specifications, send out notices and let contracts may or may not be very important. In general it may be said that political considerations loom largest in selling to local governments, less so in selling to states, and least of all in selling to the federal government.

II. SELLING TO THE FEDERAL GOVERNMENT

The federal government uses all things that are sold. Unfortunately, it is not a single purchaser, but many. The purchases of some goods are centralized for all *but* its corporate appendages. Thus, the Procurement Division of the Treasury purchases most of the "supplies." The Post Office Department purchases most of the stationery; the Navy buys most of the fuel and lubricating oils. The Army and Navy may or may not use the Procurement Division. Within itself, the Navy has centralized purchasing; however, the Army has not. Further-

[8] It is unfortunately impossible to mention names; however, the purchase director of one of the largest governments in this country recently told the writer that his unit habitually takes discounts on contracts which are 1/10 n. 30 by paying in *fifteen* days—and gets away with it.

more, many of the numerous federal corporations go their own way and do almost all of their own purchasing, although they are bound by some of the federal purchasing laws, such as the Walsh-Healey Act.[9]

The General Accounting Office

As now constituted, the General Accounting Office makes an audit of all federal noncorporate expenditures as to (1) the legality of the expenditure and (2) the correctness of the method used. As to some corporations, such as the TVA, it makes a less drastic audit; and it has no power at all over some other corporations (such as the Panama Railroad Co.). If a procuring official feels that a proposed expenditure is of doubtful legality, he can ask for a "pre-audit." In all cases the General Accounting Office makes a "post-audit." *No* expenditure is legal without the assent of the General Accounting Office in cases over which it has jurisdiction.[10]

The Court of Claims

It is an elementary principle of the Common Law that you cannot sue a sovereign without his consent. If the sovereign consents to be sued and suffers judgment, you cannot collect from him unless he is good enough to pay. The federal government does not consent to be sued in tort or in equity;[11] however, it does consent to be sued in contract in the Court of Claims after the appropriate administrative official has refused payment of the claim.[12] This court sits without jury, and its findings may be appealed from only on points of law.[13] Equitable claims may be considered by the Comptroller General in his discretion.[14]

Federal Specifications

A letter circular of the U. S. National Bureau of Standards says, in part:[15]

Members of the staff of the National Bureau of Standards take

[9] 41 U.S.C. 35–41.
[10] 31 U.S.C. 71.
[11] *Bigby v. U.S.* 188 U.S. 400, 47 L. Ed. 519, 23 S. Ct. 468 (1903); 28 U.S.C. 250.
[12] 28 U.S.C. 250.
[13] 28 U.S.C. 288.
[14] 45 Stat. 413.
[15] LC-497, pp. 2–4.

an active part in the work of many technical committees of the Federal Government, particularly those engaged in the preparation of specifications. In this way the results of the investigations and tests made in the Bureau's laboratories are made available to these committees in the preparation of Federal specifications.

The Federal Specifications Executive Committee (FSEC), Procurement Division, Treasury Department, prepares and promulgates purchase specifications for the use of all Government departments and establishments. These specifications embody the best judgment of all Federal agencies as to the requirements for a given commodity which at the lowest cost will give satisfactory service.

The procedure for the formulation of a Federal specification is as follows: The need of a specification for a given article or material is fully considered by the Federal Specifications Executive Committee. If the specification is to be prepared, the work is assigned to a technical committee composed of representatives of each branch of the Federal Government interested in the particular subject, for consideration of all existing government and/or commercial specifications. After a specification has been selected or formulated which will be suitable for the uses intended, by all departments and establishments of the government, it is then submitted for comment and criticism to all agencies of the Federal Government and interested trade associations. All criticisms received are referred to the respective technical committee which may revise the proposed specification if it is found to be desirable or necessary. When approved by the technical committee and the FSEC, it is promulgated as a Federal specification by the Director of Procurement for use by all Government departments when purchasing the commodity specified. The specification so promulgated remains in effect until it is either rescinded or revised.

Up to April 1, 1937, the Federal Specifications Executive Committee had adopted and promulgated over 1100 Federal specifications covering a wide range of commodities.[16] These specifications have had a profound effect in governmental purchasing. Many of the States and cities are now using them almost exclusively as part of their contracts for purchases. All Federal specifications are issued in printed form and are obtainable from the Superintendent of Documents, Government Printing Office, Washington, D. C., at a nominal price. Any State or municipal purchasing officer desiring to do so can keep abreast of the current specifications used by the Federal Government by requesting from the Superintendent of

[16] [Note: As of June, 1939, these numbered over 1,200. (Release of the Bureau, June, 1939).]

Documents, or the National Bureau of Standards, from time to time, copies of the latest list of Federal specifications.[17]

A manufacturer may have a product which would be satisfactory for the government's use; but if it does not fit the government specification, the government will not buy. The supplier should ask himself three questions: (1) Does my product fit the specifications, if any, in the Federal Standard Stock Catalog? (2) If not, how much would it cost me to change my product? (3) Is the prospect of federal purchase of my product important enough to warrant my pulling administrative and political strings to get the specification changed? In asking the third question we are assuming (a) that the product is good enough for the government's use and (b) that the product has a strong political pull—such as the fact that it is made of American-produced material (such as cotton) whereas the present specification calls for a foreign-produced material (such as jute). It is to be noted that a person who gets a specification changed acquires thereby no "inside track," but merely a chance to compete.

It is to be remembered that many government corporations do not purchase through the Federal Standard Stock Catalog, and hence are free to use their own specifications.

The Walsh-Healey,[18] Bacon-Davis,[19] and "Buy American" Acts[20]

The Bacon-Davis Act, which applies to all contracts for federal construction where the amount involved is $2,000 or more (and which includes coast guard vessels, boats and aircraft)[21] was enacted in 1931. It provides that construction contracts of more than $2,000 must contain a stipulation that the contractor will pay wages of at least what the Secretary of Labor has determined to be the "prevailing minimum wage" for each class of labor involved.[22] The Secretary is not obliged to hold a hearing before determining the wages.[23] Hours of work must be not more than eight a day.

[17] Price List No. 75, Federal Specifications, Federal Standard Stock Catalog. Obtainable free from the Superintendent of Documents, Government Printing Office, Washington, D. C., or the Division of Codes and Specifications, National Bureau of Standards, Washington, D. C.
[18] 41 U.S.C. 35–45.
[19] 40 U.S.C. 276a–276a-6.
[20] 41 U.S.C. 10, 10a.
[21] O.A.G. Mar. 6, 1936.
[22] 40 U.S.C. 276a.
[23] *Gilbert Engineering Corp. v. U.S.* 82 Ct. of Claims 616.

The Walsh-Healey Act declares that all contracts for the making or furnishing of goods and supplies in an amount exceeding $10,000 must contain provisions that the person making *or* furnishing goods has paid all persons on this job at least the prevailing minimum wages for their locality and work, and that they have not worked more than 8 hours a day or 40 hours a week. The Secretary determines prevailing minimum wages after a hearing. This Act does not apply to goods already manufactured and bought from stock,[24] or to materials bought on the open market.[25] It should also be noted that if a wholesaler sells goods to the government, he need only certify that *he* has paid the prevailing minimum wages. Both the President and the Secretary of Labor have authority to exempt contracts from the operation of the Walsh-Healey Act.

Reference has already been made to the "Buy American" Act.[26]

Lists and Blacklists

The federal government does not generally advertise in the newspapers. Most federal purchasers "advertise" by mailing invitations to bid to approved sources of supply—manufacturers and "regular dealers."[27] A manufacturer can generally get on these lists by asking. However, a contractor who has made trouble for a federal purchaser is likely to find himself on an unofficial but genuine blacklist. A private publication, the *U. S. Government Advertiser*, which is issued weekly, contains a listing of invitations, bids, and awards on government purchases throughout the country.[28]

Who Buys

At the beginning of this discussion of selling to the federal government there was some discussion as to who does the federal purchasing. This may perhaps be amplified here. The Procurement Division of the Treasury was established by executive order[29] of the President on June 10, 1933. It was reorganized on June, 1939, by Director's order No. 73.[30] This

[24] 41 U.S.C. 35.
[25] 41 U.S.C. 42.
[26] *Supra*, Section IA.
[27] 41 U.S.C. 5.
[28] See the reference to this publication in Section III–C, *infra*.
[29] No. 6166.
[30] Approved by President Roosevelt June 10, 1939.

order provides[31] that, "The Procurement Division, Treasury Department shall hereafter undertake the performance of the procurement of all supplies for use either at the seat of government or in the field for all existing government agencies and such agencies hereafter created: *Provided*, that any agency may perform such procurement itself to the extent permitted by the Director of Procurement, until such dates as the Director may designate with respect to specific agencies, specific kinds of procurement or specific supplies." It is also provided[32] that "the provisions of this order shall not apply to the War and Navy Departments and the Marine Corps."

Miscellaneous Statutory Provisions

A great number of statutes hedge about the federal buyer. Some have been referred to. Here are a few others (but by no means all): No land may be bought unless specially authorized by law[33] and unless the title has been approved by the Attorney General.[34] Furniture must be procured through the Treasury Department.[35] Contractors for buildings must be bonded.[36] No advance of public money may be made.[37] Products of the federal prison industries must be used, if possible.[38] All printing must be done in the Government Printing Office unless specially exempted by law.[39] The Criminal Code provides[40] that no person interested in a corporation "shall act as an officer or agent of the United States for the transaction of business with such corporation."

Government Corporations

It is difficult to generalize on the subject of government corporations. For example, the statute referred to immediately above does not apply to them;[41] however the Walsh-Healey Act does.[42] It has long been established that government cor-

[31] Section 2.
[32] *Ibid.*, Sec. 6.
[33] 41 U.S.C. 14.
[34] 40 U.S.C.
[35] 40 U.S.C. 283.
[36] 40 U.S.C. 269, 270.
[37] 31 U.S.C. 529.
[38] 18 U.S.C. 744ff.
[39] 44 U.S.C. 14.
[40] Criminal Code § 41; 18 U.S.C. 93.
[41] *U.S. v. Strang*, 254 U.S. 491, 41 S. Ct. 165 (1921).
[42] 41 U.S.C. 35.

porations may be lawfully established; however, it is not yet clear to what extent they are like government and to what extent like private corporations. Generally speaking, the earlier cases, starting with the first[43] tended to consider a corporation owned by the government *as* government. The later cases[44] tend to treat government corporations and their officials in most respects like private corporations. With the exception of the Walsh-Healey Act, selling to them is a great deal like selling to other businessmen. Of course, it must be remembered that everything said here is subject to change; the government is constantly being reorganized.

III. SELLING TO THE ARMED FORCES

Nowadays we hear much of the phrase "industrial mobilization," and of proposals to "draft industry." Strictly speaking, these words are misleading. They carry with them the impression that the government intends to "take over" and to "run" industry in time of war. While the writer has no authority to speak for the War and Navy Departments, it may be said that it is his impression that no such drastic steps are contemplated. The War Department has frequently stated that it desires to take no more control over industry than is absolutely necessary. Apparently the chief use of the extensive powers possessed by the military establishments will be as a threat against manufacturers who are reluctant to sell to the government excepting on their own terms.

The treatment here given to this enormously important subject is necessarily very general. The situation is so dynamic that what is of importance today may only be of historical interest tomorrow. Thus, Mr. Leo M. Cherne wrote a book entitled *Adjusting your Business to War*. His preface was dated April, 1939. By the time the work was published in July of that year, much of the material was out of date.[45] Mr. Cherne's staff currently publishes a loose leaf service on this subject.[46] While the writer is not necessarily in agreement with all of

[43] Chief Justice Marshall in *McCulloch v. Maryland*, 4 Wheat. 316 (1819).
[44] *Kiefer and Kiefer v. R. F. C.*, 59 S. Ct. 519 (1939); *Graves v. N. Y. ex rel O'Keefe*, 59 S. Ct. 595 (1939); *U. S. Shipping Board Merchant Fleet Corp. v. Howard*, 281 U.S. 19, 50 S. Ct. 372 (1930).
[45] A second edition of this work was published in 1940.
[46] *The War Co-ordinator*, edited by Leo M. Cherne, published by The Research Institute of America, New York City. Another loose-leaf service is "The National Defense Service," published by Prentice-Hall, New York City.

Mr. Cherne's statements, a perusal of his service is recommended to those who are specially interested in the subject.

Compulsory Orders

Title 50, U. S. Code, Sec. 80[47] provides in part as follows:—

> The President, in time of war or when war is imminent, is empowered, through the head of any department of the Government, in addition to the present authorized methods of purchase, to place an order with any individual, firm, association, company, corporation, or organized manufacturing industry for such product or material as may be required, and which is of the nature and kind usually produced and capable of being produced by such individual [etc.]. . . .
>
> Compliance with all such orders shall be obligatory . . . and shall take precedence over all other orders and contracts . . . and any individual [etc.] . . . or the responsible head or heads thereof owning and operating any plant equipped for the manufacture of arms or ammunition, or parts of ammunition, or any necessary supplies or equipment for the Army, and any individual [etc.] . . . or the responsible head or heads thereof owning or operating any manufacturing plant . . . who shall refuse to give the United States such preference . . . at a reasonable price as determined by the Secretary of War . . . then . . . the President . . . is hereby authorized . . . to take immediate possession of any such plant or plants and through the Ordnance Department of the U. S. Army . . . to manufacture such product as may be required. . . .

This Act then proceeds to make noncompliance with this section a felony. It is also provided in the same section that "The compensation to be paid to any individual, firm, association, company, corporation or organized manufacturing industry for its products or material, or as rental for use of any manufacturing plant while used by the United States, shall be fair and just."

The Selective Training and Service Act of 1940, which was approved by the President on September 16, 1940, has a substantially identical provision[48] which is operative in peace time. The few verbal differences are of a minor character; the effect is the same. There is the same provision that compensation "shall be fair and just."

[47] Often referred to as Section 120 of the National Defense Act of 1916.
[48] Section 9.

In the war of 1917–18 the Army used Sec. 80 chiefly for two purposes: (1) as a threat to induce reluctant manufacturers to bid on government contracts; (2) to enable manufacturers who were already working at full capacity to be relieved of such part of their civilian contracts as was still executory. Some such use may be made of Sec. 9 of the Selective Training and Service Act of 1940.

Forms of Contract

Recent legislation[49] has given the Navy the power to make what are called "negotiated contracts" in certain instances.[50] The exact nature and extent of this authority is not clear at the date of this writing;[51] however, a few characteristics of the "negotiated contract" are set forth in the legislation. These contracts may be let "without advertising or competitive bidding upon determination that the price is fair and reasonable." The legislation expressly says that while "the cost plus a percentage of cost system of contracting" may not be used for "negotiated contracts," cost plus a fixed fee may be used; and in that case, the fixed fee shall not exceed 7 per cent of the estimated cost.

The War Department has power to "negotiate" contracts, and it has recently used this power.[52] As the stress of the national defense program becomes greater, it is to be expected that contracts will be let in an increasingly informal manner. In the light of the lessons of the War of 1917–18, one may hazard a guess that the armed forces may occasionally overstep the bounds of their legal restrictions if the pressure of the need for materials becomes sufficiently severe.

Information

There are several current sources of information as to "who buys what." One of these is a private publication, the *U. S. Government Advertiser*,[53] which is issued weekly and which con-

[49] Public No. 671, 76th Congress (H.R. 9822).

[50] In the purchase or repair of "naval vessels or aircraft, or any portions thereof . . . and also for machine tools and other similar equipment."

[51] September 27, 1940.

[52] New York *Times*, October 5, 1940. Whatever power the Army now has (November, 1940) to "negotiate" contracts comes from Public No. 703, 76th Congress (July 2, 1940) and Public No. 781, 76th Congress (September 9, 1940). Neither statute uses the word "negotiate."

[53] Published by U. S. Government Advertiser, Inc., 511 Eleventh Street, N.W., Washington, D. C. This is available for inspection at the district offices of the U. S. Bureau of Foreign and Domestic Commerce.

tains a large number of notices of invitations for bids on army and navy work. A more generalized source is a processed pamphlet issued by the Bureau of Foreign and Domestic Commerce entitled, *National Defense—Procurement Planning, Purchasing, and Contracting (Revised) August, 1940*. This lists the various purchasing offices of the Army and Navy and indicates the classes of materials bought by each office. This pamphlet, which may be obtained free of charge from any district office of the United States Bureau of Foreign and Domestic Commerce, will probably be revised again in the future. It may be noted that as the national defense emergency becomes more acute, the method of calling for bids becomes more informal, and less open to public inspection.

The Problem of the Small Manufacturer

The writer, from his conversation and correspondence with purchasing officers of the Army and Navy, can say that small or medium-sized manufacturers will often have some difficulty in selling to the armed forces in 1940 and 1941. Formerly, when their requirements were relatively small, the armed forces had great difficulty in getting bids. Now, when requirements are very large, the Army and Navy must perforce favor large manufacturers, as they need great rapidity in delivery. The purchasing officers of the armed force show a considerable reluctance to split up large orders into small lots, as this increases the cost of purchasing, receiving, and inspection, and adds to the labors of an already overworked staff. It is, of course, possible that at some time in the future the plants of the larger manufacturers may get overloaded. If this happens, there may well be a tendency to break up the orders into smaller lots. By November 10, 1940, this effect was already noticeable in some lines.

For a long time it has been a proverb with many public purchasing officers that honesty is necessary, but the *appearance* of honesty is even more essential. Because of this philosophy, small and inexperienced manufacturers have been given free opportunity to bid; and public purchasers have regarded these suppliers as an unavoidable nuisance. Now there has been a change of emphasis. The paramount requisite is to get the goods, and get them quickly; and the armed forces must perforce trade on the fine *reputation* for honesty which they have built up during the last generation.

IV. SELLING TO STATE GOVERNMENTS

Each state has its own statutes, which usually specify in some detail how the government shall purchase what it uses. The remarks below are therefore generalities. This article sets forth what may be expected; however, it cannot serve as a substitute for a detailed knowledge of the statutes and individual setup of the different states.

Who is the Vendor?

The new Secretary of Finance[54] in State A belonged to the X political party. When asked by the state Purchasing Agent what his policy would be, the Secretary replied, "If price and quality are equal, buy from a State A supplier; if price and quality are equal, buy from an X Party supplier. If there is any difference, buy the best and the cheapest." The purchasing statute commanded, in effect, "The state Purchasing Agent shall buy from the best and lowest bidder." The Procurement Director of State B recently told the writer that his office favored local suppliers, "other things being equal," although there was, he asserted, no party preference at all. The purchasing law of State B provides that the Procurement Director shall take "the lowest bid." States A and B are large and important states. The writer has been informed by a disinterested observer that State C, which is a small one, goes much further as to both state and party preference. The phrase "the best and lowest bidder" is very commonly found in purchasing laws.

Sometimes statutes expressly authorize *local* preferences. The Massachusetts statute gives, "A preference in the purchase of supplies and materials, other considerations being equal, in favor, first, of supplies and materials manufactured and sold within the Commonwealth, and, second, of supplies and materials manufactured and sold elsewhere within the United States."[55] The Rhode Island statute says, "The State Purchasing Agent, in making purchases or contracts in behalf of the state where the amount involved is in excess of $500, shall give merchants, dealers and manufacturers in the State of Rhode Island an opportunity to compete for such purchases or contracts, and if price and quality are commensurate, the mer-

[54] These are actual occurrences. Titles are somewhat changed in order to preserve anonymity.

[55] Mass. G. L., C. 7, Sec. 22 (17).

chants, dealers and manufacturers of Rhode Island shall be given such contracts."[56] Illinois gives a preference to locally produced coal.[57]

Extent of Centralization; Notice

In most states the purchase of some articles for the state's use is centralized. Frequently there is a purchasing agent who is an employee of the department of finance. In Michigan the state purchasing agent buys only articles to be used by state *institutions;* however, local governments may also use his services if they desire.[58] In Ohio the Superintendent of Purchases and Printing buys all goods for the use of the state *excepting* for state institutions governed by boards of trustees, and the highway department; but he may authorize any officer to do any or all of his own purchasing.[59] In New York the Superintendent of Standards and Purchase has an employee entitled Director of Purchase, who does all purchasing for the state excepting supplies for the legislature and articles expressly exempted by the Superintendent's rule on order.[60] In Mississippi the Board of Public Contracts makes purchases only of state printing, binding and fuel, heat, light, and water for the capital building.[61]

Where the purchase of a particular article is centralized, the statutes provide for a wide variety of methods of notice. In Texas[62] the Board of Control is required to send out bids to all persons or firms on their mailing list for the article required. To get on the mailing list the supplier must pay an annual fee of not less than $5.00 nor more than $7.50; payment of the charge entitles him to notice as a matter of right. In Ohio the Superintendent of Purchases and Printing is required by statute to purchase all articles costing $150 or more by competitive bidding. He must notify "competing persons" by registered mail at least fifteen days before opening the bids.[63] However, in Ohio, there is no prescribed method of getting on either the list or the blacklist. In Wisconsin all invitations for bids must

[56] G. L. of Rhode Island (1938), C. 5, Sec. 14, Clause E.
[57] 127 Smith-Hurd 28.
[58] Mich. Ann. Stat. Sec. 3, 391.
[59] Ohio G. C. Sec. 154–37.
[60] State Finance Law, Sec. 111.
[61] Code (as amended) Sec. 5922.
[62] Vernon's An. Rev. Stat. Art. 634a, Sec. 1.
[63] Ohio G. C. Sec. 196–7.

be published in the "State paper."[64] Illinois has an interesting law which was apparently intended to benefit the newspapers rather than either businessmen or the state. Advertisements for bids for supplies or construction work for the state must be published for at least three days, the first and last of which shall be ten days apart, in one or more papers published in each of the *seven* largest cities in Illinois, and, *in addition*, in one secular English language newspaper selected by the Department of Finance by competitive bidding, which shall be the "official newspaper" for one year.[65]

A large and important state, which I shall call State D, has very expensive advertising provisions; however, the legislature never appropriates enough money to pay for the advertisements. The purchasing officer therefore ignores the law and advertises only once in one newspaper instead of (let us say) three times in four newspapers. Practically all of D's purchases over the last decade have been unlawful.

If one is selling a product which is not subject to centralized purchasing, one must make contact with officials in consuming institutions by means of salesmen or other agents.

The Right Officer and the Proper Formalities

The states, like the federal government, are sovereign; they may only be sued by their own consent and on their own terms. Generally there is a semiofficial board of sundry claims, which passes on claims, with or without hearings, and recommends special acts to the legislature.[66] This is, of course, highly unsatisfactory; and it therefore becomes especially necessary to the vendor to make certain that he is dealing with a person who has authority to act.

It is usual to provide that orders amounting to less than a certain sum may be made informally. The limit is $3,000 in Wisconsin,[67] $1,000 in Illinois[68] and New York,[69] $500 in Massa-

[64] Wisconsin Comp. Stat. Sec. 15. 336.

[65] 127 Smith-Hurd 28. The newspapers apparently put so much pressure on the legislature to get this remarkable statute on the books that it was passed in slightly different forms twice in one day. The Smith-Hurd annotator says that *both* variants are the law.

[66] As in Ohio. In Michigan, for example, the State Board of Auditors serves a similar function—see Mich. Ann. Stat. Sec. 3.451.

[67] Code, Sec. 15.33.

[68] 127 Smith-Hurd 28.

[69] State Finance Law 120.

chusetts,[70] and $150 in Ohio.[71] These exceptions permit a varying degree of informality.

Often the purchasing statutes do not include any provision for emergencies. However, as it is general for purchasing agents to have authority to make rules exempting purchases from the operation of the law, informal emergency purchases may *generally* be made *if* the purchasing agent has ruled accordingly in advance. In general it may be said that the vendor must ascertain the proper officer at his peril.

In many states the letting of public printing contracts differs from other public contracts. In some states the letting of printing contracts is specially provided for in the constitution.[72] Sometimes it is imperfectly consolidated with other public purchasing.[73] In other states the Department of Finance is a successor to the old Supervisor of Public Printing.[74] In other states, such as Massachusetts[75] no distinction is made between printing and other purchases. The apparent reason for these distinctions is that public printing was one of the earlier and more flourishing of grafts, and hence was the first class of public contracts to receive detailed statutory attention. Almost all purchasing laws contain such vestigial members.

As a caveat it should be added that the purchasing laws of the several states have odd kinks; about these generalizations are impossible. One example should suffice. Thus, the Illinois statute provides[76] that: "All contracts for coal purchases shall be let to secure as nearly as is practicable a fair distribution of employment to miners employed throughout the state. All contracts are made subject to the approval of the governor." Another Illinois law commands that all contracts for fuel *excepting* coal shall be let to the lowest bidder.[77] But Illinois has not yet said the last word about coal; the last word is:[78] "The price paid for fuel shall not exceed the following: For anthracite coal, $12 per ton, for Pennsylvania bituminous, Pocahontus, and

[70] G. L. C. 7, Sec. 22.
[71] G. C. 196–7.
[72] Viz. Wisconsin Constitution, Art. IV, Sec. 25; Michigan Constitution, Art. V, Sec. 25.
[73] Thus in New York the Division of Standards and Purchases lets printing contracts under the Public Printing Law. Sec. 3, and all other contracts under the State Finance Law, Secs. 110 and 111.
[74] Viz. Ohio G. C. Secs. 154–26 and 154–37; 71 Purdon 640 (Pa.).
[75] Mass. G. L. C. 7, Sec. 22.
[76] 127 Smith-Hurd 28.
[77] 127 Smith-Hurd 29.
[78] 127 Smith-Hurd 30.

West Virginia Smokeless, Eastern Kentucky and Ohio coals, all of the bituminous types, $9 per ton. For Illinois, Indiana, Western Kentucky, Missouri, and Iowa coals, all of the bituminous types, $7 per ton. For any other coals of the bituminous types, $7 per ton."

Specifications and Testing

The state purchasing authority, by whatever name it is called, has generally the power to set specifications for state-used material and equipment after consultation with the using officers.[79] Occasionally it is provided that the using officials have the right to frame their own specifications.[80] The states use the Federal Standard Stock Catalog and the Commercial Standards in varying degree. State B referred to above makes wide use of these; State C uses them hardly at all.

Often, testing is inadequate, as it is in State B; there are not enough funds for the purpose. Sometimes testing is left largely to the using officials as in State A; sometimes the central purchasing authority has the testing duty.[81]

Manufacturing by State Institutions

Practically all states have statutes declaring that all state departments and institutions must buy products of the state's prison industries (and sometimes other state institutions, in addition) whenever possible. Occasionally the law goes even further and provides that municipalities, too, are bound.[82] As has been mentioned, the federal government is likewise obliged to purchase the products of the federal prison industries.[83] In such cases the private vendor is, of course, absolutely shut out of that part of the market.

State "Authorities"

The states, like the federal government, have many corporate or quasi-corporate appendages.[84] Many states have

[79] Michigan Ann. Stat. Sec. 3.39–1; N. Y. State Finance Law, Secs. 113, 120; Mass. G. L. C. 7, Sec. 22 (8); Rhode Island G. L. C. 5, Sec. 14; Wis. Code, Sec. 15.29, 71 Purdon 633(a) (Pennsylvania); North Carolina P.L. 1931, C. 261.

[80] Viz., Texas, Ann. Rev. Civ. Stat., Art. 652.

[81] As in Massachusetts. G. L. C. 7, Sec. 22 (14), Sec. 22 (15), and Sec. 24.

[82] Mass. G. L. C. 127, Secs. 53–68.

[83] 18 U.S.C. 744.

[84] In 1937 New York State had 31 "authorities," including the Port of New York Authority, which it owns jointly with New Jersey—P. J. Nehemkis, Jr. "The Public Authority," 47 *Yale Law Journal* 14 (1937).

liquor monopolies, which are often quasi-corporate. Most states have state universities, generally governed by boards of trustees. Depending on the individual case, selling to one of these bodies may be like selling to the state, or it may be like selling to a private corporation.

V. SELLING TO LOCAL GOVERNMENTS

Due to the enormous range of the size of local governments, it is difficult to generalize very much. For example, New York City in 1937 received in cash $1,402,361,066, and paid out $1,416,487,321.[85] Its purchases generally run in the neighborhood of $29,000,000 annually.[86] In one fiscal year Los Angeles County, California, bought through its purchasing and stores department $11,014,502.64 worth of materials and supplies.[87] On the other extreme there are minuscule villages and desert counties which use but little and purchase that informally. There are, however, some points of similarity.

The Ultra Vires Question

To a very considerable degree municipal corporation law is antiquated private corporation law. Originally all corporations were chartered by the King, later by special act of legislature. Their charters set forth what they could do; if they did acts which were not listed in the charters, as far as the law was concerned, they were not done. Such acts were nullity; they were *ultra vires.* If a corporation purchased goods for an *ultra vires* purpose and had used them, the vendor had no remedy against the corporation. The corporation *had no power* to pay. These restrictions have been greatly relaxed in the case of modern general corporation statutes. Corporations may now be organized for any lawful purpose. If the corporation's agent does an act which the charter does not permit, the corporation will have an action against him; but the outsider will not be injured.

Until very recently the legislatures and courts have been more hesitant to give full power of local self government to municipal corporations. Except, then, in states which have full

[85] World Almanac.

[86] The Department of Purchase bought in value of goods as follows: 1938, $26,640,542.86; 1937, $29,089,104.34; 1936, $24,597,388.64—Report to Mayor LaGuardia on the work of the Department of Purchase, City of New York for the year 1938. Russell Forbes, Commissioner. August, 1939.

[87] Survey Report of the Purchasing and Stores Department, Oct. 1, 1937, p. 28.

"home rule" for cities and counties, *ultra vires* is still a major problem.

Generally, a municipal corporation or other entity of local government has no extramural powers without express authority from the legislature or state constitution.[88] However, even where there is no "home rule" an enabling act may authorize a city to construct a municipal stadium outside the city limits.[89] The most extreme case is one in which a city was enabled to build a double track railroad more than 300 miles long and situated entirely outside the *state*.[90] As the functions of local government have become more varied and widespread, such restrictions have tended to become more and more onerous.

There is an increasing tendency in cities to offer inducements to manufacturing enterprises to locate within their limits. Generally, it may be said that these arrangements are *ultra vires* and void;[91] a city should use its resources for public purposes only. In the absence of express legislative sanction, a municipal corporation has no authority to engage in private enterprise.[92]

The powers of cities vary widely. Ohio cities have "home rule" and can adapt charters more or less at their discretion.[93] The City of New York has fairly wide powers, as expressed in its charter.[94] But the City of Chicago has such narrow rights that it was held that, although it had power to make garbage removal contracts for five-year periods, this did not include power to make five-year contracts for the removal of dead animals and condemned meat.[95] The size of a city has therefore but little to do with the extent of its powers. Contracts creating debts in excess of municipal debt limits have been held to be *ultra vires* and void;[96] and cities have been enjoined from collecting taxes to pay such obligations.[97]

[88] Eugene M. McQuillin, "The Law of Municipal Corporations," 2nd Ed., Sec. 365; Wm. Anderson, *The Extraterritorial Powers of Cities*, 61 Am. L. Rev. 671–693 (1927); *Taylor v. Dimmit*, 336 Mo. 330, 78 S.W. (2d) 841, 98 A.L.R. 995 (1934).

[89] *Cathcart v. Columbia*, 170 S.C. 362, 170 S.E. 435 (1933).

[90] *Walker v. Cincinnati*, 21 Ohio St. 14 (1871).

[91] *Lowell v. Boston*, 111 Mass. 454, 15 Am. Rep. 39 (1873); McQuillin, *op. cit.* Sec. 376.

[92] *Taylor v. Dimmit*, supra; *Cleveland v. Ruple*, 130 Ohio St. 465, 200 N.E. 507, 103 A.L.R. 853 (1936); McQuillin, *op. cit.*, §375.

[93] Ohio Constitution, Article XVIII, Sections 3 and 7.

[94] *N. Y. City Charter Adopted Nov. 3, 1936* by L. A. Tanzer, Clark Boardman Co., Ltd., 1937.

[95] 24 Smith-Hurd 101, 104, 643, 644; *Avery v. Chicago*, 345 Ill. 640, 178 N.E. 351 (1931).

[96] *Underwood v. Fairbanks, Morse & Co.* 205 Ind. 316, 185 N.E. 118 (1933).

[97] *Oklahoma Utilities v. Heming*, 2 Fed. Supp. 849 (1933).

The powers of counties also vary widely. Eight states—California, Louisiana, Maryland, Montana, New York, Ohio, Texas, and Virginia—have constitutional home rule for counties; however, in some of these, home rule is limited.[98] Los Angeles County, California, seems to have been the first county to have written its own charter (in 1913). On the other hand, some counties are vestigial in function, and exist only for the administration of justice, the recording of documents, etc.[99] The Commissioner of Purchase of the City of New York does all the buying for the five counties within the city limits.[100]

Municipal corporations have some of the attributes of sovereignty: they cannot be sued in tort unless they are acting in a "proprietary capacity"; however, they may be sued in contract.[101] Yet if a contract is *ultra vires*, there can be no recovery against the municipality.[102] The invalid contract cannot afterward be ratified by the municipality.[103] The municipality cannot be estopped to deny the validity of its contract.[104] There can be no recovery on the basis of implied contract.[105] Moral claims may, however, be paid by act of council.[106]

Double Interest

It is, of course, easy to say that where a public body is buying something its contracting officer should not have a financial interest in the contract. However, the courts have gone very far in finding this double interest; and it is hard for municipal officials (who are often part-time public servants) to keep from having one. A list of a few recent situations will illustrate this difficulty. The lease of a municipal wharf to a firm in which the city marshall was a member was held void,[107] as was a city's purchase of real estate from the wife of the mayor (who voted

[98] *Home Rule for Counties Continues its Progress*, E. A. Mauck, 28 National Municipal Review 89–95, 179 (Feb., 1939).

[99] Thus the five counties within the City of New York, and most New England Counties.

[100] N.Y.C. Charter (1936), Sec. 782a.

[101] McQuillin, *op. cit.*, Sec. 799.

[102] *Portsmouth Co. v. Town of Anson*, 186 Atl. 883 (Maine, 1936).

[103] *Hoskins v. Orlando*, 51 Fed. (2d) 901 (U.S.C.C.A., 1931).

[104] *Hill Co. v. Ventnor City*, 77 N.J. Eq. 467, 78 AH 677 (1910); *Williams v. Fary*, 63 N.D. 183, 247 N.W. 46 (1933).

[105] *Columbus v. Public Utilities Com.*, 103 Ohio St. 79, 133 N.E. 800 (1921); *Hay's Exp. v. Burns*, 216 Ky. 827, 288 S.W. 764.

[106] *Shaddock v. Schwartz*, 246 N.Y. 288, 158 N.E. 872 (1927).

[107] *Arms & Short v. Denton*, 212 Ky. 43, 278 S.W. 158 (1925).

for the purchase in the city commission).[108] A contract between a city and a member of its charter commission was held void.[109] Where a city contracted with a corporation in which a councilman was general manager and a stockholder, this contract was held void.[110] Similar invalidity was found in a case where the contractor was the partner of the mayor.[111] It will be noted that in many of these cases, the person who had the double interest had nothing to do with the letting of the contract. The Standard Form of Contract Proposal of the City of New York requires a bidder to "affirm and declare":

> 3. That no member of the Council, head of a department, chief of a bureau, deputy thereof or clerk therein, or other officer or employee of the City of New York is or shall become interested directly or indirectly, as contracting party, partner, stockholder, or otherwise, in the supplies or work for which this bid is submitted or in the performance of the contract to which it relates, or in any portion of the profits thereof.

If this were literally adhered to, New York City could not buy any gasoline; for surely there is no oil company in which some officer or employee of the City of New York is not financially interested.

The Right Officer

Centralized purchasing is becoming more and more frequent in cities; however, relatively few counties seem to have a purchasing agent. Occasionally they do, as in Los Angeles County.[112] However, this seems to be the exception to the rule.

There is a great mass of cases in which a vendor has sold goods or services to a local government, but has acted through the wrong officer. The law concerning the consequences of such a course of action is in great confusion; however, the most common view seems to be that such a contract, if executory, is void; but that if the municipality has used the goods or accepted the services, the vendor may recover the reasonable value of the goods or services. This is what is often called "quasi-contract."

[108] *Woodward v. Wakefield*, 236 Mich. 417, 210 N.W. 322 (1926).
[109] *Marxer v. Saginaw*, 270 Mich. 256, 258 N.W. 627 (1935).
[110] *Miller v. Martinez*, 82 Pac. (2d) 519 (Cal. App. 1939).
[111] *State ex rel Streif v. White*, 282 S.W. 147 (Mo. App. 1926).
[112] Survey Report of the Purchasing and Stores Department, Los Angeles County Bureau of Efficiency, 1937; Charter, Art. VI, Sec. 24.

Formalities

Often a statute or charter specifies how a contract shall be made. Some common provisions are: all goods costing more than $xx must be purchased by certain named officials; but items costing less than that may be bought by using officials. If the amount of the purchase is more than $yy the letting of bids must be advertised in a certain manner; if the amount is more than $y, the contract must be let by competitive bidding. Bids must be submitted in duplicate (or triplicate, etc.). The contracting officer either may or must require a bond for faithful performance if the value of the contract exceeds a certain amount. Often all contracts must be made in writing. Some contracts must be made by the city council itself. Sometimes sealed bids are required. Sometimes there is a preference for local suppliers.

Each state has its own rules for the consequences of not observing each particular formality. The law on the subject is very inconsistent. In general it may be said that if a particular formality is of a basic sort (such as competitive bidding) the nonobservance of it forbids *any* recovery for the work or materials furnished: this is what is called a *mandatory* requirement. If, however, the requirement is a minor incident in the formation of the contract, (such as: that bids must be submitted in duplicate) then it is said that the requirement is *directory*, and recovery is allowed either on the contract or for the reasonable value of the goods or services furnished.

Information

Many local governments advertise their major requirements in some kind of a publication. Sometimes a city publishes an official "newspaper" or "record" which contains all official advertisements, and which is therefore clearly worth the subscription price to the prospective vendor.[113] More frequently the most reliable source of information is personal contact.

CONCLUSIONS

Few Purchasing Laws Are Well or Completely Planned

In general, most public purchasing systems are essentially unplanned. Like Topsy, they were not born; "they just grew."

[113] Examples: New York City; Cincinnati.

They consist of amorphous masses of legislative, administrative, and judicial mandates, each of which was formed to fit a specific occasion rather than a general need. Frequently in a state or municipality someone, at some time or other, sat down and constructed a "general purchasing law." However, in few cases was the system thus engendered well-reasoned or complete; and subsequent changes have usually been made in the law to fit particular occasions. Administrative legislation frequently follows a definite cycle. First a state (let us say) is found to have a poor form of organization due to generations of patchwork and haphazard legislation: lines of authority are tangled by a maze of independent and quasi-independent officers and boards. Next, the legislature perceives the administrative disunity and enacts an administrative code which "reorganizes," standardizes, and unifies governmental procedures and creates a somewhat more logical structure. The third and final stage occurs when the legislature, wishing to "take out of politics" some of its pet schemes, sets up independent boards once again and exempts them from general laws. After a decade or so the state is ripe for another "reorganization."[114] Clearly, at any one time most states and cities are in either the first or the third stages of the cycle. This state of affairs is apparent in the many exceptions to the centralization of purchasing which may be found in all units of government.

The Degree of Coördination Achieved in Purchasing Varies with the Size of the Unit

It is fairly easy to have unified and centralized purchasing in cities, counties, and even in a state as small as Rhode Island; and many units of government on this level have methods of purchasing which are well thought out and competently executed. The activities of a large state are more varied both in type and in space; and it is not, therefore, surprising to find that their methods of purchase are less completely organized than the better run units of local government. As for the federal government, attempts to unify and coördinate its multitude of purchasing functions have been so feeble as to hardly exist at all. Such centralized purchasing as exists is largely

[114] This concept of the cycle of administrative reorganization has been developed by Dr. Howard L. Bevis, (under whom the writer studied in this University. Dr. Bevis is now President of Ohio State University).

permissive and performs an infinitesimal part of the total purchasing function.

Special Interests Bring in Motives Extraneous to the Purchasing Function

In many respects public purchasing is similar to the buying done by large industrial concerns. Buying of major requirements is very generally done by specification and bid rather than by brand name; high quality and speedy delivery take precedence over the less rational consumer demands and prejudices.

Yet it should by no means be assumed that the public purchaser is solely a "price buyer." He is required to achieve many other purposes. He must often give preference to goods of local origin—and "local" may mean "made in U.S.A.," or "made in Massachusetts," or even "made in Boston." He must often give either open or concealed preference to goods made under "fair labor standards"—and he thereby aids the unions. He must also lend a helping hand to the home-state penologists by buying goods made in local prisons (although he is generally forbidden to buy goods made in the institutions of *other* states). He must often do a ridiculous amount of advertising—for the newspapers, although they denounce legislative favors granted to unions, are not backward in seeking their own best interest. Finally, the public purchaser must tread the narrow path that winds among legal restrictions and obstacles the reason for which has often been forgotten or become obsolete. When the sum is taken of all of these special mandates, prohibitions, and preferences, the result is often that obedience to the letter of the law becomes the end rather than the means of public purchasing.

The Basic Motives of the Public Purchaser Are Conflicting

A priori reasoning would lead us to conclude that the chief objects of the public purchaser are to get the goods (1) honestly, (2) cheaply, and (3) quickly. While it is true that these are all legitimate objectives, it is also true that each of these aims is in direct conflict with the other two. In order to protect the purchaser from political pressures and favoritism elaborate systems of notice and competitive bidding are constructed by

statute, ordinance, or administrative rule, as the case may be. These consume both time and money and prevent the purchaser from maintaining the valuable commercial contacts which are of such assistance to the commercial buyer. Similarly, if you are to buy at the best market, you cannot buy on absolute requisition. The result of these restrictions is that honesty and efficiency do not necessarily go hand in hand, as reformers are prone to assume.

Thus we are confronted with a primary fact: public purchasing agents are subjected to more pressures than are private industrial buyers,[115] and hence a system which insures honesty often robs the buyer of so much discretion that he has no chance to be efficient. The *appearance* of honesty becomes of paramount importance. It is therefore no surprise that the restrictions on purchasing by the armed forces have been drastically reduced in 1940. When you have to get the goods and get them quickly, you have little time to worry about the appearance of honesty. You must be free to buy where you can and from whom you can, and to offer both a price and a form of contract which will bring forth suitable vendors. You cease to worry about giving all responsible persons a chance to bid: you want to give the order to the supplier who can give assurance of the speediest delivery.

On the other hand, it must be admitted that the rigidities which are so often found in the purchasing laws, ordinances, and regulations are conducive to honesty in the sense that preferences tend to become class or group priorities rather than individual favoritism. When the state is securing its normal peacetime requirements, perhaps this is better than nothing. Yet surely there is much room for improvement in the purchasing systems of this country on all levels of government.

[115] The writer, however, expresses no opinion on the integrity of industrial purchasing agents.

THREE TOPICS IN COMPARATIVE ADMINISTRATION—

Organization of Government Departments, Government Corporations, Expenditures in Relation to Population

Arnold Brecht

SUMMARY

STUDIES *in comparative, as well as in American, administration should not deal exclusively with administrative law and the existing organizational order. Real administration is dynamic in nature. It begins where administrative law ends or is being created, i.e. where discretionary power may be used. International comparison is an excellent means of stimulating the dynamic approach. Three cases are here presented.*

I. Organization of Government Departments. *In the United States high administrative units have been organized either as integral parts of departments or as quasi-independent agencies. In Germany the separate, yet subordinated, type of agency has traditionally been preferred. This method keeps the departments themselves compact even in times of rapidly expanding functions. The permanent core of such a department can easily be organized in accord with what we know to be the effective span of control. The relation between the departments and the separate bureaus, the functions of the liaison officers, and the reasons why the latter should not be identical with the bureau heads, are discussed. The adoption and adaptation of this method is recommended for improving administrative machinery in the United States.*

II. The Government Holding Corporation. *The United States Government supervises almost all its corporations directly. It has retained direct supervision even in cases where the financing has been done through the RFC. Democratic Germany established, and Hitler Germany continued, a central body, resembling a holding company, for financing and supervising numerous government corporations. This body serves to separate business control from political control, to avoid working at cross-purposes, and to reduce the burden of the regular departments. The question of establishing such a central control body in the United States is submitted for further consideration. The establishment of a central auditing body for corporations is recommended.*

III. Expenditures in Relation to Population. *There is a definite correlation between public expenditures and the density of population. But for studying its causes and effects, statistics dealing with cities cannot be relied upon as the sole test of this correlation. These statistics not only leave rural sections unanalyzed, but they do not allow for unequal contributions from states. Comparisons of total expenditures per capita in the several states bear out the correlation between population and expenditure increase to a surprising extent, if standards of intensive conglomeration rather than average density are used. Some questions are left open as to the influence of pure chance, of concomitant causes and of statistical shortcomings of the analysis. The comprehensive German financial statistics show the correlation even more clearly than do the American figures. The rate of total per capita expenditures ranges from four to one in the United States, from three to one in the German states.*

THE EDITORS

WHEN FRANK J. GOODNOW initiated the systematic study of comparative administration in 1893, he rightly called his book "Comparative Administrative *Law*" rather than "Comparative *Administration*." In chapters full of valuable material he dealt with the separation of powers, central and local administration, the law of officers, administration in action, and control over administration, considering in each case the United States, Great Britain, France, and Germany. Although some of his headings seem to refer to administration rather than administrative law, he treated almost exclusively the legal aspects with particular emphasis on constitution and organization. This is true even of the thirty-two pages which he devoted to administration in action. Anticipating the *Stufentheorie* of the Vienna School, he described the various levels through which the authority to express the will of the state is delegated from higher to lower and lowest authorities, and the main types of action they take. He soon left the topic of action, however, and hurried on to devote more than one hundred and sixty pages to that of control over administration.

Administrative law limits the range of administrative discretion granted, but does not disclose how, within these levels, the discretion is used. The science of administration properly so called should focus attention upon the use made of discretion. There is, to be sure, no hard and fast line between the two, as

discretion often is best exercised by granting authority to subordinate agencies. In such cases the very use made of discretion is to pass some of it on to lower authorities and thus to grant them new discretionary powers. To describe this procedure is to describe both administrative law and administration. Organization can always be regarded in these two ways, as the discretion *granted* to each agent or as the discretion *used* in granting (delegating) such discretion—administrative law being the static aspect, administration proper the dynamic or creative aspect of organization.

The administrator's full ability is elicited and tested only when he retains a choice of what to do and how to do it. The legislature, free to change administrative law within the constitutional framework, can show its administrative ability by the way it uses this broad power of legislation. The executive administrator, unless he is advocating new legislation, will accept a statute as a given thing and apply his abilities only within its limits. The outside critic and student of administration may deal with the creative administrative aspect both in legislation and execution. Administration proper always begins where administrative law ends—or is being created.

Although this seems to be obvious, writing and teaching ever tends to minimize the truly administrative view. Time and again students of administration find themselves allured by legal border-line questions, such as separation of powers, judicial review, legal power of appointment and removal, instead of discussing the commendable use of discretion.

There are laudable exceptions, however. In a number of fields the constitutional and legal view has been pushed into the background in order to focus attention upon the more strictly administrative problems. Among them are office management, personnel, finance, and local administration.[1] Nevertheless, too much of the field is still treated formalistically. There is also an ever-recurrent tendency to freeze any progress made into static forms of laws or principles, whose wisdom can often be challenged as can the juggernaut of established organization. There may be alternatives better suited to modern demands.

[1] The young science of public administration has accomplished a partial revival, which only deserves to be more general, of the old cameralistic science. Cf. A. W. Small, *The Cameralists: The Pioneers of German Social Polity* (Chicago, 1909).

Comparison of different methods is an excellent means of checking administrative organization and principles. In studying the institutions and methods used by foreign countries our creative efforts may be stimulated. Some topics have already been ably exploited to such purpose. The main differences in the organization of the various countries are familiar to every student of government. The main differences in dealing with the personnel problem have likewise been widely disseminated. In special branches, such as statistics, taxation and budgetary procedure, and especially in new fields of administration such as unemployment insurance, extensive comparison of methods has become customary. But there are many other useful fields for comparative studies.

One real difficulty is, however, involved in all such studies. Books and documents published abroad fail to give adequate data. Where they seem to do so they are preoccupied with the static aspect. Hence in trying to describe the dynamic practice of administration one suffers all the handicaps of second-hand knowledge. To overcome this handicap one would have to enlist the coöperation of experts with first-hand experience abroad.

In the following pages we take up three out of many topics of comparative administration which may prove important. In view of the limited space and the difficulty just mentioned it seems wise to concentrate on America and Germany instead of scattering our efforts over a variety of countries.

ORGANIZATION OF GOVERNMENT DEPARTMENTS

Expansion of administrative activities has everywhere inflated the departments of the national government. The space occupied, the number of buildings, floors, halls, entrances, elevators, information desks, has multiplied in many a department. So have the employees of all ranks, the mail, incoming and outgoing, the callers, telephone calls, files, indexes, and conferences. Inevitably congestions and bottlenecks have increased, too. This development, aggravated by the geometrical progress which it entails in the increase of interrelations, tends to threaten the efficiency of the nation's administrative headquarters.

According to American tradition, the highest administrative units in Washington, D. C., have been organized either as

integral parts of one of the departments or as quasi-independent agencies. But there is another potential form of organization which seems particularly well suited for keeping administrative headquarters compact and efficient, namely, to set up an agency as a separate and distinct unit, but to subordinate it to the higher unit. Confronted with administrative expansion much earlier than other countries, Germany has systematically developed this latter type of centralized unit. Ever since the foundation of the Empire one accepted administrative technique has been to detach any bureau which in a technically well-defined field assumes a considerable scope of business, from the national department under whose jurisdiction it belongs, and to establish it as a separate, subordinate unit.[2]

This device separates the space occupied by such a bureau as well as its mail, callers and employees, from the space, mail, callers, and employees of the department proper. If this method is applied systematically in all suitable cases the departments can be kept small in size and few in number even when public administration expands.

Table I lists a selection of bureaus which are organized as either independent agencies or departmental bureaus in the United States, while their equivalents constitute separate yet subordinated units in Germany. At first sight one may wonder whether there is any relevant difference between the two latter types. Supposing for the sake of simplification that the general organization of the bureau, and also its location, is the same in both cases, it may appear irrelevant whether the bureau is integrated in a department or separated although remaining under its supervision. The head of the bureau may be left the same degree of independence in both cases. In fact many bureau heads have obtained such independence in the United States.

Yet the difference is very remarkable even under such assumptions. If all the large and busy departmental bureaus with their hosts of employees and clients are detached, there

[2] See Arnold Brecht and Comstock Glaser, *The Art and Technique of Administration in German Ministries* (Cambridge, Mass., 1940), pp. 6 ff. Big business enterprises with their special branches and affiliated institutions, and even universities with their law schools, business schools, girls colleges, etc., have long followed similar lines of organization in the United States. But these illustrations do not reveal the typical advantages which result for the political organization of departments and interdepartmental relations, nor is the structure quite comparable, as will be seen below.

TABLE 1

Separate Yet Subordinated Bureaus Versus Integrated or Independent Bureaus

United States		Germany	
Bureau (Departmental or Independent Type)	**Part of (Department)**	**Bureau (Separate yet Subordinated Type)**	**Subordinate to (Department)**
1. Geological Survey	Interior	*Reichsamt für Landesaufnahme*	Interior
2. (a) Central Statistical Board (b) Bureau of the Census (c) Bureau of Labor Statistics	Executive Office of the President Commerce Labor	*Statistisches Reichsamt*	Economics[a]
3. Bureau of Standards	Commerce	*Physicalisch-Technische Reichsanstalt*	Science and Education (formerly Interior)
4. Patent Office	Commerce	**Reichs-Patentamt*	Justice
5. (a) Government Printing Office	Independent	(a) *Reichsdruckerei*, *Reichsverlagsamt*	Post Interior
(b) Bureau of Engraving and Printing	Treasury	(b) *Reichsdruckerei*	Post
6. Mint	Treasury	*Staatsmünze*	Finance (Prussia)
7. Social Security Board	Federal Security Agency (formerly Independent)	(a) **Reichsversicherungsamt* (b) **Reichsanstalt für Arbeitsvermittelung und Arbeitslosenfürsorge*	Labor
8. (a) Public Health Service (b) Food and Drug Administration	ditto (formerly Treasury) ditto (formerly Agriculture)	*Reichsgesundheitsamt* (partly)	Interior
9. Bureau of Biological Survey[b]	Interior (formerly Agriculture)	*Biologische Reichsanstalt* (partly)	Food and Agriculture
10. Bureau of Agricultural Economics, Tobacco Section	Agriculture	*Reichsanstalt für Tabakforschung*	ditto
11. Bureau of Plant Industry, Animal Industry, Dairy Industry, etc.	ditto	*Reichsstellen für Getreide, Öle und Fette, Milchwirtschaft, etc.*	ditto
12. Bureau of Chemistry and Soils	ditto	*Chemisch-Technische Reichsanstalt* (partly)	Science and Education
13. Public Buildings Administration	Federal Works Agency (formerly Treasury)	*Reichsbaudirektion*	Finance
14. Civil Service Commission	Independent	(a) **Reichsjustizprüfungsamt* (b) **Prüfungskommission für höhere Verwaltungsbeamte* (c) **Prüfungsämter, Prüfungsausschüsse*	Justice Interior Science and Education
15. Anuity Unit, Retirement Division	Civil Service Commission	*Finans- und Baudirektion, Pensionsabteilung*	Finance (Prussia)
16. Federal Archives	Independent	*Reichsarchiv*	Interior
17. National Museum	ditto	*Staatsmuseen*	Science and Education
18. Office of the Panama Canal	ditto	*Reichskanalamt*	Transportation
19. Federal Trade Commission	ditto	**Reichskartellgericht*	Economics
20. Bituminous Coal Division	Interior	*Reichskohlenkommissar*	ditto
21. (Federal Alcohol Administration)	Treasury	*Reichsmonopolverwaltung für Branntwein*	Finance
22. Weather Bureau	Commerce (formerly Agriculture)	(a) *Meteorologisches Institut* (b) *Reichsstelle für Erdbebenforschung*	Science and Education ditto
23. Attorney General, Criminal Division	Justice	*Oberreichsanwalt* in Leipzig	Justice

[a] The various departments are in direct contact with the Statistical Office regarding their respective fields of interest.

[b] Now part of the Fish and Wildlife Service in the Interior Department (Reorganization Plan No. III, of April 2, 1940).

NOTE. The functions of the German bureaus correspond to those of the American bureaus sometimes in full, sometimes in part, while in other cases they are determined by different legislative purposes. The present comparison is, of course, not to contend identity of functions in every detail but only to show the distinct type of organization that has been used throughout. The starred German agencies have a considerable amount of legal independence, but their administrative, financial, budgetary, and organizational concerns are handled under Ministerial supervision and mediation.

remain in each department only officers with staff functions and such line functions as do not require voluminous machinery. Some have no business with any of the subordinate agencies. Others may have supervisory functions over field offices outside the capital. A few will maintain connections with the separate yet subordinated bureaus mentioned above, one officer sometimes being in charge of several such agencies and constituting a kind of high-grade liaison officer, although he will have additional functions in the department. Whenever it becomes necessary for the detached bureau to get in touch with the head of the department or its budget officer or to negotiate with other departments on matters of particular significance, the departmental liaison officer will be called upon. He will draft general rules and regulations, or receive and handle rough drafts from the bureau. Reports and requisitions of the bureau or complaints about its activities will be assigned to him for recommendations or appropriate action. But he will not interfere with the normal executive functions of the bureau. The department head, or by his order an under-secretary or division director, will decide controversies after conference with both the bureau head and the liaison officer. As a rule there will be harmonious collaboration between these two. The bureau chief may not see his department head for months, as there is no reason to approach him personally.[3]

It is quite true that a bureau head can well attend to departmental functions or have them performed by a subordinate in appropriate cases. But then the advantages that lie in separation would be abandoned. Matters that cannot be settled by the bureau independently are as a rule of a nature which transcends its technical specialization and affects either political or general financial interests or some concern of other departments or divisions. Officers in the department who concentrate on such general questions will soon obtain a considerable knowledge regarding the many interdepartmental, financial, political, or personal points that must be taken into consideration. They will therefore be able to handle such questions with a minimum of work, friction, and time, and with the highest degree of assurance against mistakes. They can and do approach the department head or intermediate superiors daily

[3] *Op. cit.*, pp. 11, 179 ff., for further details on the functions of the departmental aide and the bureau head.

without causing congestion or delay. They can elicit the decision of the department head along with his decision in similar cases. The same advantages will also result in their conferences with other departments. Under this arrangement all departments deal on a horizontal level only with officers who have a solid knowledge of public administration. Such officials are aware of the views and principles that control all departments rather than a particular office.

To this must be added the technical advantage that lies in the reduction of business in a department. Table 2 contrasts the scheme of a United States department such as that of Agriculture with a typical German department, omitting features that have no connection with the present problem. It is readily seen that the German scheme makes it possible to observe optimum principles regarding the span of control. There is no hustling and bustling in the department, no need for congestion and impassable bottlenecks. Personal contact within and between the departments can be easily arranged in a way which serves the purposes of administration in every respect. The whole amount of official knowledge is in easy reach of the department head, the cabinet, the chief of state, and the legislature. If the department head asks his under-secretary whether and how a certain question affects the department and all its subsidiaries he can have a reliable answer almost immediately, produced by the division directors each of whom will ask his few advising officers.

There have always been shortcomings in German departments as well as in those of any other country. But whatever defects there were had nothing to do with the present problem. On the contrary the advantage of the arrangement here described has never been disputed.

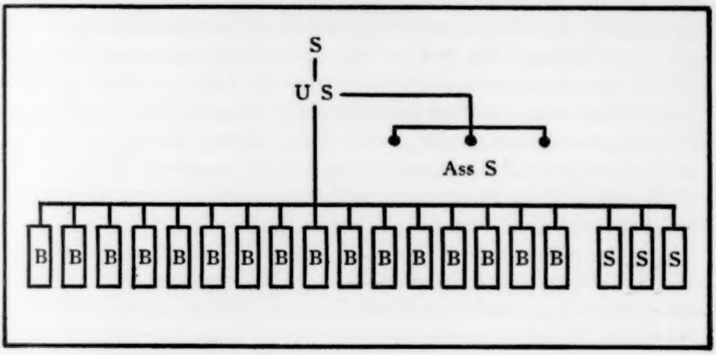
Only in rare cases has an effort been made to do without a liaison officer by giving the head of a subordinated bureau departmental duties regarding his own bureau and thus a dual function. The origin of this deviation was generally that a departmental officer who was appointed head of a detached bureau[4] wished to retain his departmental power. Thus the head of the state museum in Berlin was for some time simultaneously the principal aide in charge of fine arts in the Depart-

[4] Rank and salary of the head of a detached bureau are intermediate between those of a department principal aide and a division director.

TABLE 2

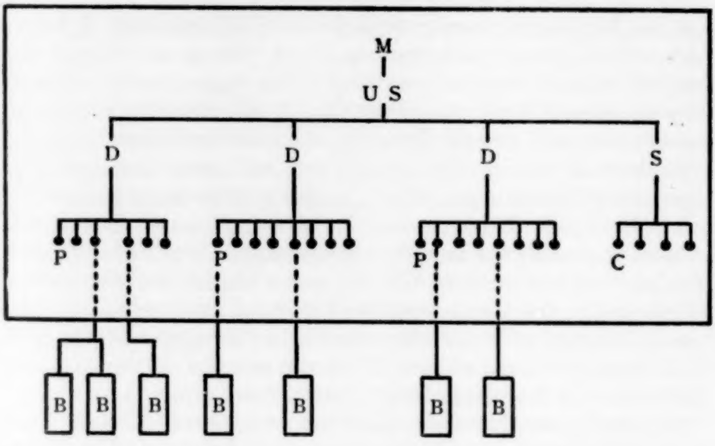
THE TWO SCHEMES OF ORGANIZATION CONTRASTED

I. Scheme of a United States Department
(Integrated Bureaus)



Key: S = Secretary
US = Under Secretary
Ass S = Assistant Secretaries
B = Bureau (average over 300 employees)
S = Service

II. Scheme of a German Ministry
(Separate yet Subordinated Bureaus)



Key: M = Minister
US = Under Secretary (German title is State Secretary)
D = Division Director
P = Principal Aides (*Referenten*) = individuals with one or two clerks, each dot standing for one P (Average about ten per Division in 1932)
B = Detached Bureaus (*Nachgeordnete höhere Reichsämter*)
S = Service (*Hauptbureau*)
C = Clerks, each dot standing for one C

ment of Education, and the head of the federal agency for public safety has frequently been in charge of the affairs of his agency in the Department of the Interior. These were exceptions, however, and of doubtful justification. The advantages of the separation became questionable under such arrangement. For the head of the bureau was then torn between his departmental and line duties. This led to the ridiculous consequence that reports or inquiries which he wrote as bureau head to the department were opened and possibly answered by himself as the representative of the department head, and he likewise could be expected to examine complaints against himself. It has therefore been most generally accepted in theory and practice that there shall be no such dovetailing.

After long and repeated consideration of all the advantages and disadvantages of the various types of organization I would strongly recommend that United States departments organize several technically well-confined bureaus as here described. This is, I think, the only device available for setting up machinery which can be efficiently run by average administrators rather than by a rare genius.

THE GOVERNMENT HOLDING CORPORATION

Public funds invested in most United States government corporations have been provided by the government directly, although as a rule with the stipulation that a multiple of the original capital may be borrowed in the open market through the issuance of bonds guaranteed by the government. Executive supervision and control, if any, is also exercised directly by the President or one of the departments, or quasi-departmental agencies added in 1939. Such financing and supervision have been arranged, in particular, for the Panama Railroad, the Alaska Railroad, the late War Corporations, the Federal Land Banks, the Intermediate Credit Banks, the Inland Waterways Corporation, the Reconstruction Finance Corporation, the Deposite Insurance Corporation, the Farm Mortgage Corporation, the Surplus Commodities Corporation, the Export-Import Bank and the Tennessee Valley Authority.

In other cases, however, the Reconstruction Finance Corporation has served as an indirect source of financing. The Home Owners Loan Corporation, the Federal Home Loan Banks, the regional agricultural credit corporations (now in liquidation),

the Commodity Credit Corporation, the RFC Mortgage Company, the Federal National Mortgage Association and the Disaster Loan Corporation have been financed in this indirect way. One of them, the HOLC, has in turn financed the Federal Savings and Loan Insurance Corporation. A mixed system has been applied, *e.g.*, to the Electric Home and Farm Authority, to which a stock of $1,000,000 has been allocated directly by the government, and a credit up to $10,000,000 by the RFC.

In these samples of indirect financing the idea of a government holding corporation has been approximated, but not fully realized. True, the statutes on the agricultural credit corporations and the Disaster Loan Corporation provided that these corporations "shall be managed by officers and agents to be appointed by the RFC under such rules and regulations as its board of directors may prescribe."[5] Regarding the RFC Mortgage Company and the Federal National Mortgage Association the RFC exercises the full rights of a stockholder on the basis of ownership. The other corporations, however, were handled in a different way. Regarding the HOLC and the Federal Home Loan Banks the RFC was directed by statute to pay the necessary amount to the Secretary of the Treasury, who subscribed to the stock, the RFC acquiring no rights of control or supervision, nor title to the payment of dividends.[6] Similarly, "all right, title and interest in and to the capital stock" of the Commodity Credit Corporation had to be transferred to the President.[7] Although the HOLC was directed to subscribe to the stock of the Savings and Loan Insurance Corporation and declared entitled to the payment of dividends, direction of the new corporation was not treated as an incidence of ownership but explicitly placed in the hands of the members of the Federal Home Loan Bank Board, who it is true also direct the HOLC. At any rate the RFC acquired neither title nor control.[8] The RFC, therefore, finds itself in the full position of a stockholder only with regard to the RFC Mortgage Company, the Federal National Mortgage Association and the Disaster Loan Corporation, in addition to property rights acquired in banks, trust and insurance companies in pursuance of its lending and supporting activities. The remaining multitude of government owned cor-

[5] *U.S. Code* 15, § 605 b; *ibid., 1940 Sup.*, § 605 k-1.
[6] *U.S. Code* 12, § 1463; 15, § 602.
[7] *U.S. Code, 1940 Sup.*, 15, § 713 a-3.
[8] *U.S. Code* 12, § 1725. The subsequent text sums up the situation as of spring 1940.

porations is supervised by various other government agencies, the Federal Loan Agency being now in control of the RFC and most of the enterprises financed through it.

The administrative problem involved in this situation is whether it is possible and desirable to simplify the structure of government corporations and to ease the administrative burden by using to a greater extent the idea of the government holding corporation.

In contrast to the RFC, the German "United Industrial Enterprises, Inc." (*Vereinigte Industrie-Unternehmungen Aktiengesellschaft*, known as *VIAG*) is a fully-developed government holding corporation. Established in 1921 expressly to facilitate and rationalize the operation of various enterprises owned by the government, it has no operating divisions of its own. Even financial operations are left to subsidiary banks, especially the *Reichs-Kredit-Gesellschaft.* Table 3, based on the annual report of 1939, shows that the holding corporation owns a nation-wide series of electric plants, aluminum plants, nitrogen plants, foundries, machine factories, in addition to two important banks and an auditing firm which may be retained by any public or private enterprise at a reasonable fee. In many cases the corporation owns the entire stock, in others the majority, while in some its share is a minority, various public or private sponsors owning the rest.

Several of the subsidiary corporations, in particular the two electric plants mentioned at the top of the list, the aluminum plant and the nitrogen plant, in turn own the stock of additional important enterprises. The *Elektrowerke A. G. Berlin* (A, 1), for instance, holds stock in thirteen major and many minor regional electric plants, sometimes a majority, sometimes a minority, the remainder being held by regional and local government bodies or private industry. Several of these second-rank subsidiaries own, in their turn, a share in further corporations. For example, the *Berliner Elektrizitäts-Union G.m.b.H.* which is itself a subsidiary of the *Elektrowerke*, owns a considerable share of the important *Berliner Kraft- und Licht A.G.*

Except for the addition of Austrian institutions, the structure of the *VIAG* is much the same now as during the democratic period. Its remarkable difference from the United States pattern is not only the broad field of activity and the elimination of direct operation, but also the fact that in each case and on all

levels the stockholding corporation rather than the government directly supervises and controls subsidiary corporations. Supervision and control are effected according to commercial law regulating stockholder influence. Commercial law also deter-

TABLE 3

STOCKS OWNED BY THE REICH HOLDING CORPORATION
(*Vereinigte Industrie-Unternehmungen Aktiengesellschaft*)
(1939)

Name	Capital in *RM*	Share of the *VIAG*	Dividend 1938 in Per cent
A *Electric Plants:*			
(1) Elektrowerke A. G., Berlin	130,000,000	full	7
(2) Alpen-Elektrowerke A. G., Wien	50,000,000	full	0
(3) Innwerk A. G., München	13,200,000	12,000,000	6
(4) Ostpreussenwerk A. G., Königsberg	26,000,000	10,740,000	5
(5) Rheinisch-Westfälisches Elektrizitätswerk A. G., Essen			
Common stock	235,600,000	5,100,000	6
Preferred stock	10,400,000	237,380	6
(6) Energie-Versorgung Schwaben A. G.	41,000,000	2,159,000	5
(7) Ilse Bergbau-A. G., Grube Ilse			
Common stock	28,000,000	7,929,200	7
Preferred stock	10,000,000	1,297,100	6
B *Aluminum Plants:*			
Vereinigte Aluminium-Werke A. G., Berlin	40,000,000	39,983,000	7
C *Nitrogen Plants:*			
Bayerische Kraftwerke A. G., Berlin	20,000,000	full	6
D *Iron and Machines:*			
(1) Deutsche Industrie-Werke A. G., Berlin	15,000,000	full	7
(2) Ilseder Hütte, Peine	42,650,000	10,698,600	8
E *Banks:*			
(1) Reichs-Kredit-Gesellschaft A. G., Berlin	40,000,000	full	6½
(2) Oesterreichische Creditanstalt-Wiener Bankverein, Wien	70,700,000	36,056,900	5
F *Auditing:*			
Deutsche Revisions-und Treuhand-A. G., Berlin	1,000,000	700,000	10
G *Others:*			*RM*
(1) Industrieanlagen G.m.b.H., Berlin	100,000	full	2,539,356
(2) Industriegelände-Gesellschaft Dresden-Albertstadt m.b.H.	480,000	full	60,000
(3) Deutsche Industrie-Versicherungsstelle G.m.b.H., Berlin	5,000	full	170,346

mines the technicalities of each organization, *e.g.*, annual meetings, annual reports, accounting, balance sheets and their publication, distribution of profits. Each enterprise issues an annual business report similar to that of any private corporation. Dividends are determined by the annual stockholder's meeting in which it may happen that but one stockholder represents the entire capital, and are paid to the stockholding corporation, which places the amount under its receipts and in turn determines the dividend to be given to its own stockholder or stockholders. The dividend of the *VIAG* fixed on the basis of the dividends received from subsidiaries is paid to the Reich Treasury, and appears in the Reich budget as an item under receipts of the Finance Ministry.[9] This item is the sole appearance of all these establishments in the Reich budget. This was true even in the democratic period. The annual report of *VIAG*, reviewing the reports of subsidiary institutions and published in accord with commercial law, used to serve as supporting material for debates on the budget. In the democratic period the general impression was that this system worked very well and certainly better than could direct government intervention.

Since the government exercises its influence not directly as a sovereign authority but only as a stockholder, it is advisable to study the composition of the officers of the *VIAG*. They are appointed at the annual meeting by the stockholding representative of the government in accordance with instruction given by those Ministers concerned with the questions involved or, in case of a controversy among them, by the cabinet or the proper cabinet committee. In line with traditional practice, the Board of Trustees (*Aufsichtsrat*) is composed of career civil servants and private individuals. The present chairman is a former civil servant, Dr. Ernst Trendelenburg, who began his career in 1908 as an assistant principal aide in the imperial Department of Justice and exercised various functions in the Department of Economics up to the position of Secretary, which he held from 1923 to 1932, when he became undersecretary general of the League of Nations, serving until Germany's secession. While the chairman is not officially connected with the government, the Ministries of Finance and

[9] The net profit for 1938 was *RM* 14,253,000.96. Out of it, a dividend of 7 per cent on the paid-up capital of *RM* 192,500,000 was turned over to the Treasury and a share, stipulated in the charter, of *RM* 133,125 to the trustees. The balance of *RM* 593,893.22 was carried forward to the next financial year.

Economics are represented by two each of their highest civil service officers. These four members act and vote according to instructions given by the government, but because of their high positions they can exercise wide discretion in determining the direction of their influence. Side by side with them on the Board of Trustees are nine leading industrialists and bankers and other experts, two of whom happen to be in governmental offices not connected with the *VIAG* (Undersecretary of Labor and President of the Prussian State Bank) while the others have no official connection with the government. There is no politician or department head on the Board.

The Board of Management (*Vorstand*) is headed by a former civil service officer of the Finance Ministry, Dr. Alfred Olscher, who was in charge of the Budget Division in that department from 1930 to 1937, after a long period of service as a principal aide in the same division. The other two members are business experts. The board, under the supervision of the Trustees, administers the shares owned by *VIAG* and as a rule uses its influence in stockholder meetings to add the chairmen of the two boards of the *VIAG*, that is two non-officials, to the trustees of the subsidiaries along with other individuals according to the requirements of the particular case. Other board members of the subsidiaries reflect the influence of other stockholders, if any. The managers of the subsidiaries, in turn, administer stocks owned by their corporations in a similar way.

The characteristic effect of this arrangement is again, as in the scheme of the separate yet subordinated bureaus, the relief of national departments as such from administrative detail. The supervision of the operations of all these complex enterprises with the aim of achieving business standards of integrity and efficiency is effected with the utmost accuracy through regular business methods without government interference. Even most decisions on the business policy of the individual enterprises are made, coördinated and checked without government interference. Whenever the government desires to exercise decisive influence, it can do so by giving appropriate instruction to its representatives on the Board of Trustees. The representatives will clear controversies among themselves through normal interdepartmental channels if necessary. Although they have no majority in the board, they hold the ultimate control since the government, as the sole stockholder,

can alter the organization and replace the officers at the ensuing formal meeting of stockholders. Such influence can be transmitted, if it should be desired, so as to determine the policy of the *VIAG*'s last subsidiary, in proportion to the government's share in the property. Departmental business, however, is hardly affected by the normal functions of administration and control.

An important element of this structure is that the current operations of all enterprises should be ruled by normal business principles. Credit institutions, for instance, would consider requests for credit only on a merit basis. Should a department support an entrepreneur's application for credit in a case of dubious security, the request would be turned down unless the government were to supply additional security, *e.g.* a governmental guarantee. The usual fees would be charged for the supply of electricity or auditing services to any government office. Such charges are graded according to general principles applying to large scale orders. Only in this way can the advantages of business structure be fully realized.

One might compare *VIAG* to an American government holding corporation organized to hold the stocks of the RFC, TVA, and other enterprises. The inclusion of TVA in its present form would, however, introduce an alien element insofar as TVA is not restricted to building and running electric power plants in conformity with business principles, but must in addition administer public functions which are not self-liquidating, such as dam building, flood control, and reforestation. If discretionary functions of a governmental or social character thwart the business accounting system, the holding corporation structure cannot work efficiently. The desirability of combining such diverse functions in the TVA is a debatable question that falls outside the subject of our discussion. In its present form, at any rate, supervision of TVA cannot be left to a holding corporation of the *VIAG* type, unless a specific sum were awarded TVA for each non-business transaction undertaken. Similarly if the service were performed by a private business concern adequate payment would have to be made under precise stipulation of work to be done.

It is impossible to go into further detail here. The data given above may suffice to stimulate ideas concerning a proper reorganization and coördination of some of the numerous govern-

ment corporations created in the United States since the World War. If the idea of a government holding corporation is adopted, the RFC should not itself become that holding corporation, but should merely be one of the institutions coördinated through it. In order to relieve the General Accounting Office of duties in fields of a distinctly business character, consideration should be given to the establishment of an auditing corporation which might offer services to all business organizations in which the government has a legitimate interest.

The main advantage of the holding-corporation arrangement would be the coördination of all budgetary, accounting, auditing, and personnel questions, as well as of business and ethical standards, and the avoidance of contradictions in purposes. In addition, the arrangement would serve to keep the departments small. These remarks are intended to open discussion rather than to give a final view.

EXPENDITURES IN THEIR RELATION TO DENSITY OF POPULATION

The mere comparative computation of per capita public expenditure does not, of course, warrant a conclusive judgment on the comparative merits of different methods of administration. Cost differences may be caused by many factors having little or nothing to do with administrative efficiency, *e.g.* benefits expected (more services, more expenditures), distribution of wealth (higher income, higher standards demanded, but possibly less need for public welfare), climate (milder climate, lower expenses for lodging, clothing, heating, food), or extent of unemployment. Disregarding such elements for the moment, let us concentrate on one factor, the influence of the density of population, which lends itself to statistical inquiries of a relatively exact nature. Such comparisons have been made in various countries especially for municipalities. It is, however, illuminating to extend them to an international level.

Even a cursory glance at municipal statistics reveals that there is a correlation between the increase in public expenditures and the increase in density of population. According to our findings to date, it seems that after an ill-defined low mark in the density of population has been reached, the total of public expenditures grows more rapidly than the total number of people, causing a rise in expenditures *per capita*, until a high mark in density is attained above which no further rise can be

noted. This phenomenon has often been observed. But we do not yet know exactly to what extent it applies, what factors are responsible for it, and what counterinfluences may explain the manifold exceptions. It has even been contended that density as such cannot be held responsible for the rise in expenditures and that the cause must be sought rather in the forms of urban life or in industrialization.[10] I do not regard this shift of emphasis as correct, for reasons which will appear below. But I do think that we must clearly distinguish among degrees of density. While not *every* increase in density raises per capita expenditures, even if it result in urbanization, *high* density ("massed conglomeration") certainly does, even where it is caused by reasons other than industrialization.[11] This view finds prima facie support in the fact that the increase in expenditure appears not so much in the many thousands of small urban communities as in the large cities and concentrations of small and big towns in a densely populated area, and that there it appears also in political and resort centers, like Washington, D. C., and Miami, Fla. There are also several prima facie reasons which evidently enough *explain* this coincidence. First, many services (such as traffic regulation, crime prevention, fire protection, street cleaning, street lighting, sewerage, garbage disposal, public health in general) require much costly care in big cities on the mere ground of dense conglomeration of people, while in small towns or rural localities they are unnecessary, of slight significance, or easily provided on a volunteer basis. Second, extreme density obviously raises the cost of personnel, which plays a leading part in *all* public expenditures. Salaries and wages have to be higher because the cost of living is unfavorably affected by the conglomeration, especially in housing, where the high value of land and the greater precautions necessary regarding fire and crime raise the costs sharply. The same factors, thirdly, increase the costs of all public buildings and their maintenance.

[10] See, in addition to the classical discussions of industrialization and urbanization by Adolf Wagner and Gustav Schmoller, a recent, talented paper by L. Edelberg, A. L. Horniker, B. Kaufmann, and L. D. Steward, "Public Expenditures and Economic Structure in the United States," *Social Research*, vol. 3 (1936) pp. 57–77, which evolved from a seminar conducted by Professor Gerhard Colm.

[11] In *Internationaler Vergleich der öffentlichen Ausgaben* (Vorträge des Carnegie-Lehrstuhls, Hochschule für Politik, Heft 2, Leipzig and Berlin, 1932) I spoke, perhaps somewhat clumsily, of the "law of the progressive parallelism between public expenditures and the massed conglomeration of population (*Bevölkerungsmassierung*)."

It is also obvious that these reasons operate fully only when the concentration of people has reached a certain degree of saturation, which varies for the respective factors. Urban life or industrial activities in small towns may not affect the real estate market so strongly as to offset the financial advantages which flow from conditions of close proximity. In very sparsely populated regions the expenditure curve may even mount, although no urban or industrial life would explain this fact, because of the high per capita costs of initial development, especially highway building and schooling (small classes or distant hauls). In middle-sized towns one or the other factor may appear sooner or later, and be more or less accentuated, according to the situation of the town in the whole region. A factor making for high expenditures may be balanced or outweighed by another element which keeps expenditure low. But in cases of very dense population, in particular of cities above the 100,000 and especially the 300,000 mark, all factors will unite to raise expenditures, although again some difference will arise from the fact of whether the city is in a desert or in a densely settled region, because in the second case real estate prices will soar higher than in the first.

Under modern conditions density, urbanization, and industrialization are closely interwoven, so that the question of their mutual contributions to the increase in expenditures may appear highly academic. Industrialization has certainly been the main cause (although not the only one) of regional density in the western world, and has as a rule resulted in urbanization. It has also added reasons of its own to the increase in public expenditures, such as factory inspection, unemployment, and relief. Also urban life as such has led to additional demands for public services, as the town dweller is not used to helping himself as does the isolated farmer. After all, it appears important to trace the extent to which the general rule works in practice rather than to theorize *a priori*.

Comparisons of local expenditures may be challenged in this context for several reasons. First, they take no account of the possibly uneven contributions made by the diverse states, counties, and special districts.[12] Second, they ignore rural

[12] Federal municipal statistics have tried to include portions of county expenditures, but only for the largest cities (over 300,000 inhabitants) and by rough allotment. This was done to improve comparison among the largest cities, but

regions, at least in the United States. Third, inhabitants being counted according to administrative boundaries, municipal units in metropolitan areas (such as Yonkers, White Plains or New Rochelle, N. Y., Brookline or Cambridge, Mass., or Pasadena, Cal.) are classified as relatively small places rather than as parts of areas with millions of inhabitants.

Comparison among various states can overcome these three defects by combining state and local expenditures per capita of population. In the United States such comparison is possible on the basis of the decennial *Financial Statistics of State and Local Government*, as compiled by the Bureau of the Census for 1932. Here again, consideration only of city expenditures makes the influence of the intensive conglomeration of people seem quite obvious.[13] If however the *combined* per capita expenditures of state and local governments are compared among the various states, regularity seems to disappear. This fact has baffled many observers and led them to question the validity of the rule.[14] Yet the impression is deceptive. Correct analysis will restore basic regularity. For this purpose Table 4 enumerates the states in order of combined per capita expenditures of state and local units and adds *several* data on population density for each state, referring not only to the average density but also to the conglomeration in big cities or their absence. The arrangement, though confusing at first sight, shows much conformity with the rule when viewed at closer range.

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it simultaneously disturbed comparison between small and large cities. Special districts, too, are partly included in federal municipal statistics, but only where the districts are coextensive with the cities. This again disturbs rather than facilitates comparison from level to level.

[13] At least if the nation as a whole and the various sections are considered. In four of the individual states were the per capita expenditures of cities of over 30,000 inhabitants exceeded by those of smaller towns. Yet these were states without cities of 100,000 or more inhabitants.

[14] Thus the authors of the coöperative article mentioned above. Their analysis is not conclusive, however, because they fail to draw the line with "massed conglomeration" on the one side and extreme sparsity on the other. Instead, they cling to such isolated factors as average density of state population, a particularly poor criterion in vast areas with the low averages prevailing in the United States, which does not reveal conglomeration in big cities. This leads the authors, for instance, to the absurd assumption that Rhode Island, because of its higher state average in density, should have higher per capita expenditures than New York State (p. 61). When contrasting numbers of inhabitants the authors draw the line unfortunately at the low level of 2,500 or 10,000 inhabitants (p. 59 n.) instead of 50,000, 75,000, or even higher. These methods could neither establish nor disestablish the rule as here expounded, although some details of the analysis are most valuable.

TABLE 4

PER CAPITA GOVERNMENTAL–COST PAYMENTS OF STATES AND SUBDIVISIONS OF STATES, 1932[a]

Rank in Expenditures per Cap.	State	Expenditures per Cap. (in Dollars)	Inhabitants per Sq. Mile	Per cent of People Living in Places of: Over 300,000 Inh.	Over 100,000 Inh.	Less than 2,500 Inh.	Number of Cities of Over: 100,000 Inh.	30,000 Inh.
1	Nevada	130.99	0.8	—	—	62.2	—	—
2	New Jersey	129.97	537.8	18.8	31.0	17.4	6	22
3	New York	127.96	264.2	62.2	66.8	16.4	7	22
4	California	113.78	36.5	33.0	43.1	26.7	5	17
5	Wyoming	104.97	2.3	—	—	68.9	—	—
6	Delaware	103.80	121.3	—	45.0	48.3	1	1
7	Arizona	98.50	3.8	—	—	65.6	—	2
8	District of Columbia	97.83	7852.7	100.0	100.0	—	1	21
9	Massachusetts	96.31	528.6	18.4	41.7	9.8	9	9
10	Washington	96.22	23.4	23.4	37.6	43.4	3	5
11	Wisconsin	90.74	53.2	19.7	19.7	47.1	1	10
12	Oregon	87.66	10.0	31.7	31.7	48.7	1	1
13	Michigan	86.86	84.2	32.4	39.1	31.8	3	15
14	Minnesota	86.36	31.7	18.1	32.7	51.0	3	3
15	Connecticut	85.21	333.4	—	35.7	29.6	4	8
16	Idaho	83.00	5.3	—	—	70.9	—	—
17	New Hampshire	81.03	51.5	—	—	41.3	—	2
18	Colorado	80.85	10.0	—	27.8	49.8	1	3
19	Iowa	80.77	44.5	—	5.8	60.4	1	7
20	Maine	79.66	26.7	—	—	59.7	—	2
21	Montana	79.47	3.7	—	—	66.3	—	1
22	Illinois	76.46	136.2	44.2	45.6	26.1	2	20
23	Louisiana	76.34	46.3	21.8	21.8	60.3	1	3
24	Rhode Island	74.58	644.3	—	36.8	7.6	1	4
25	Ohio	73.24	163.1	20.3	40.1	32.2	8	23
26	South Dakota	71.94	9.0	—	—	81.1	—	1
27	Utah	70.89	6.2	—	27.6	47.6	1	2
28	Maryland	70.83	164.1	49.3	49.3	40.2	1	3
29	Pennsylvania	70.13	214.8	27.2	31.1	32.2	5	20
30	Kansas	68.47	23.0	—	12.4	61.2	2	3
31	Vermont	68.13	39.4	—	—	67.0	—	—
32	North Dakota	65.45	9.7	—	—	83.4	—	—
33	Nebraska	64.80	17.9	—	15.5	44.7	1	2
34	Florida	64.68	26.8	—	23.2	48.3	3	5
35	Indiana	63.92	89.8	11.2	24.3	44.5	5	13
36	Missouri	58.40	43.4	33.7	33.7	48.8	2	5
37	New Mexico	55.14	3.5	—	—	74.8	—	—
38	Oklahoma	54.10	34.5	—	13.6	65.7	2	3
39	Texas	52.35	22.2	—	18.0	59.0	5	13
40	West Virginia	48.47	72.0	—	—	71.6	—	3
41	Virginia	43.86	60.2	—	12.9	67.6	2	6
42	Tennessee	40.33	62.8	—	24.2	65.7	4	4
43	North Carolina	40.07	65.0	—	—	74.5	—	8
44	South Carolina	39.47	57.0	—	—	78.7	—	2
45	Arkansas	36.65	35.3	—	—	79.4	—	2
46	Kentucky	36.09	65.1	11.8	11.8	69.4	1	4
47	Mississippi	35.47	43.4	—	—	83.1	—	2
48	Alabama	33.67	51.6	—	9.8	71.9	1	3
49	Georgia	33.62	49.5	—	9.3	69.2	1	5
	All States and subdivisions	76.80	41.0	20.8	29.9	43.8	94	310
	Federal government	41.16	41.0	20.8	29.9	43.8	94	310
	Federal, state and local governments	117.96	41.0	20.8	29.9	43.8	94	310

[a] The per capita expenditures are taken from *Financial Statistics of State and Local Government, 1932* (Bureau of the Census, Washington, D. C., 1935), the population figures from the 1930 census.

Per capita expenditures range from $130.99 down to $33.62, *i.e.* at a ratio of four to one. The first sixteen states, each with per capita expenditures of $83 or more, assume a place in the upper third of the list well in accord with the rule. For ten of them include one or more cities of over 300,000 inhabitants each, three of the cities surpassing the million mark. Another state in this group, Connecticut, has an average population of more than 300 per square mile, a level reached by only four other units in the country. In Delaware, 45 per cent of the people live in a city with more than 100,000 inhabitants, a percentage equalled by only three other states. Crowded conditions of life, therefore, account fully for the high places held on the list by these twelve states. The four remaining states of the top-expenditure group (Nos. 1, 5, 7, 16) illustrate the opposite extreme. Each has less than six inhabitants per square mile, and three are without a single city at the 30,000 level.

At the bottom of the list are ten states showing an expenditure of less than $50 per capita. This, too, is in line with the rule. For none of these states has more than 75 or less than 35 inhabitants per square mile, that is, none is either so densely or so thinly settled that the concentration factor can boost expenditures. In each of them the large majority of the population (from 65 per cent to 83 per cent) live in rural regions without bringing the average down to extreme sparsity. In addition, five have no city of over 100,000 inhabitants. Only Kentucky offers a contradictory feature, as it has in Louisville a border city of over 300,000 inhabitants, which fact does not, however, drive the weight of big-city inhabitants higher than 11.8 per cent.

The remaining twenty-three states (Nos. 17 to 39) have medium expenditures between $52.35 and $81.03 per capita. In ten of this group (Nos. 18, 20, 26, 27, 30, 32-34, 38, and 39) the medium level is explained by the absence of any factor making for either high or low expenditures. In these ten states the population density is between 6 and 35 per square mile, which seems high enough to avoid very large expenditures, but too low to bring expenditures down to the optimum. In three other states (Nos. 23, 35, 36), factors making for high and low expenditures balance each other. Five more states, although

not quite in their proper order, are not far from the group to which their population density seems to direct them, i.e. Vermont (No. 31) close to the lower group, Montana, Illinois, Rhode Island, and Ohio (Nos. 21, 22, 24, 25) not far from the upper group.

There remain, then, only five units out of forty-nine where the population analysis decidedly fails to explain their level of expenditures. They are New Hampshire (No. 17) and Iowa (No. 19), which would be expected to appear considerably lower because of medium density, and Maryland (No. 28) and Pennsylvania (No. 29), which would be expected to appear higher because of high density, and New Mexico (No. 37) which would be expected to appear higher because of extreme sparsity. All five cases are from the middle group, showing that the departure from the law is, in any case, not fundamental in character. Particular reasons to explain the deviations can be easily found, partly through a closer analysis of the distribution of population within the area, partly in environmental or individual conditions. In the case of New Mexico, for instance, the expenditures are almost exactly the same as in adjacent Oklahoma and Texas; great poverty and the high percentage of Indians, who are under the care of the federal rather than state government, may also play a role.[15]

Table 5 gives a graphic presentation of the distribution of factors which make for high, low, and medium expenditures.

Despite these favorable arguments for the general validity of the rule, several doubts might be sustained on the sole basis of American figures. For instance, one might argue that the ten states of the lowest group happen to belong to or to adjoin the South and that therefore lower standards, fostered by the climate, the economic system, and the negro element, explain the lower cost of government without reference to population density. The high-cost states with sparse population are all in the West; again their mountainous character and economic system may explain their high cost of government better than the factor of "extreme" sparsity of population.

Further, the accuracy of the statistical data might reasonably be challenged. All grants-in-aid are reported in duplicate as expenditures of the granting state and of the receiving local

[15] The per capita personal income in New Mexico is less than half that in Nevada, less than two-thirds that in Arizona. It is tenth lowest of all the States.

TABLE 5

DISTRIBUTION OF FACTORS WHICH MAKE FOR HIGH, LOW OR MEDIUM EXPENDITURES IN THE STATES OF THE UNION

	High Expenditures ($131 to $83 per Cap.)																Medium Expenditures ($82 to $52 per Cap.)																							Low Expenditures ($49 to $33 per Cap.)									
	Nev.	N. J.	N. Y.	Calif.	Wyo.	Del.	Ariz.	D. C.	Mass.	Wash.	Wis.	Ore.	Mich.	Minn.	Conn.	Ida.	N. H.	Colo.	Iowa	Me.	Mont.	Ill.	La.	R. I.	Ohio	S. Dak.	Utah	Md.	Pa.	Kan.	Vt.	N. Dak.	Neb.	Fla.	Ind.	Mo.	N. Mex.	Okla.	Tex.	W. Va.	Va.	Tenn.	N. Car.	S. Car.	Ark.	Ky.	Miss.	Ala.	Ga.
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	38	39	40	41	42	43	44	45	46	47	48	49
I. Factors which coincide with high expenditures:																																																	
(1) Massing of population																																																	
(a) over 100 inh. per sq. mile	.	+	+	.	.	+	.	+	+	.	.	.	.	.	+	.	.	.	.	.	.	+	.	+	+	.	.	+	+	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.
(b) over 300 inh. per sq. mile	.	+	.	.	.	.	.	+	+	.	.	.	.	.	+	.	.	.	.	.	.	.	.	+	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.
(c) over 70% inh. living in urban places	.	+	+	+	.	.	.	+	+	.	.	.	+	.	+	.	.	.	.	.	.	+	.	+	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.
(d) cities over 300,000 inh.	.	+	+	+	.	.	.	+	+	+	+	+	+	+	.	.	.	.	.	.	.	+	+	.	+	.	.	+	+	.	.	.	.	.	+	+	.	.	.	.	.	.	.	.	.	+	.	.	.
(e) over 30% inh. in cities over 100,000	.	.	+	+	.	+	.	+	+	+	.	+	+	+	+	.	.	.	.	.	.	+	.	+	.	.	.	+	+	.	.	.	.	.	.	+	.	.	.	.	.	.	.	.	.	.	.	.	.
(f) over 30% inh. in cities over 300,000	.	.	+	+	.	.	.	+	.	.	.	+	+	.	.	.	.	.	.	.	.	+	.	.	.	.	.	+	.	.	.	.	.	.	.	+	.	.	.	.	.	.	.	.	.	.	.	.	.
(2) Extreme sparsity of population																																																	
(a) 6 or less inh. per sq. mile	+	.	.	.	+	.	+	.	.	.	.	.	.	.	.	+	.	.	.	.	+	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	+	.	.	.	.	.	.	.	.	.	.	.	.
II. Factors which coincide with low expenditures:																																																	
(1) Over 35 inh. per sq. mile *and*																																																	
(a) not more than 100 inh. per sq. mile	.	.	.	+	.	.	.	.	.	.	+	.	+	.	.	.	+	.	+	.	.	.	+	.	.	.	.	.	.	.	+	.	.	.	+	+	.	.	.	+	+	+	+	+	+	+	+	+	+
(b) over 60% inh. living in rural places	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	+	.	.	+	.	.	.	+	.	.	.	.	.	.	.	+	.	.	.	.	.	.	.	.	+	+	+	+	+	+	+	+	+	+
(c) no city over 100,000 inh.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	+	.	.	.	.	.	.	.	.	.	.	.	.	.	+	.	.	.	.	.	.	.	.	+	.	.	+	+	+	.	+	.	.
(2) Absence of factors which make for high expenditures	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	+	+	+	+	.	.	.	.	.	+	+	.	.	+	+	+	+	+	.	.	.	+	+	+	+	+	+	+	+	.	+	+	+
III. Factors which coincide with medium expenditures:																																																	
(1) Over 6 but not over 35 inh. per sq. mile	.	.	.	.	.	.	.	.	.	+	.	+	.	+	.	.	.	+	.	+	.	.	.	.	.	+	+	.	.	+	.	+	+	+	.	.	.	+	+	.	.	.	.	.	.	.	.	.	.
(2) Absence of factors which make for high or low expenditures (I and II, 1 a-c)	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	+	.	+	.	.	.	.	.	+	+	.	.	+	.	+	+	+	.	.	.	+	+	.	.	.	.	.	.	.	.	.	.
(3) Balance of such factors in part or full	.	.	.	+	.	.	.	.	.	.	+	.	+	.	.	+	.	.	.	.	.	.	+	.	.	.	.	.	.	.	.	.	.	.	+	+	.	.	.	.	.	.	.	.	.	+	.	.	.
IV. Level of expenditures in considerable contradiction to population factors	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	.	+	.	+	.	.[a]	.[a]	.	.[a]	.[a]	.	.	+	+	.	.[a]	.	.	.	.	.	+	.	.

[a] Deviation from the proper grouping not very strong.

government.[16] Although such grants were not so important in 1932 as now, this duplication must considerably spoil the accuracy of the figures. Moreover, the per capita figures give only the gross expenditures, so that a city running its own water or electricity plant shows much higher expenditures than a city which obtains water and electricity from private utilities, although the rates may be the same and completely cover the cost, even leaving a surplus.[17] Finally, the per capita figures include capital outlay indiscriminately, which entails similar errors.[18]

Notwithstanding the gravity of these objections, it seems that the general results are by no means misleading but fully in accordance with a valid basic law. Climatic and economic peculiarities work only to stress or mitigate the general influence of this law, to set it in another scale, but not to thwart it. Technical defects of American statistics are made relatively negligible by the compensating effect of large numbers and seem rather to modify results which otherwise would be even more striking.

International comparison tends to harden these contentions. In the '20s the German democratic government inaugurated thorough statistics of public expenditures of all governmental units on the basis of a well prepared schedule. Every state and community or other government unit had to list annual expenditures according to a uniform standard. Duplication of figures for grants-in-aid was eliminated. Special columns made it possible to separate gross and net expenditures, as well as recurrent expenditures and capital outlay. The more than 60,000 reports were carefully compiled and edited by the Reich Statistical Office. One of the main purposes of this painstaking work was to compare expenditures in individual states and supply basic data for a noble competition in economy. The results seemed highly confusing and baffling, until analysis according to the law of the progressive influence of massed conglomeration offered a surprising key.[19] After a few years these compilations were restricted.[20]

[16] *Financial Statistics of State and Local Governments*, 1932, p. VII.

[17] This defect has been eliminated in figures for states and cities of over 100,000 inhabitants, as published since 1939 starting with the figures for 1937.

[18] It can be easily demonstrated that for these reasons the use of these statistics for individual comparison of city and city is highly misleading and distorting.

[19] This was the purpose of my essay of 1932, mentioned in note 11.

[20] The German financial statistics were inaugurated by ordinances of February 9, 1926 (*Reichsgesetzblatt* I, p. 109) and July 25, 1927 (*ibid.*, p. 245), which ordered

They are valuable for the present purpose not only because of their exactness. Only three of the German states had less than 200 inhabitants per square mile, as have forty-two of the forty-nine units of the United States, and none had below 97 per square mile, as have thirty-eight states in the United States. Excessive sparsity of population may therefore be completely absent as a factor which makes for high per capita expenditures, and only the opposite factor of massed conglomeration may be expected to operate. The climatic conditions of the country are less diversified than in the United States, as are standards of living and of public service. Therefore the German statistics offer a pure and convincing illustration of the influence of population density.

Table 6 shows expenditures as of 1928, a pre-depression year. They vary almost exactly in the order of population density from RM 332 in Hamburg, where 94 per cent of the people live in a big city, to RM 102 in Lippe, where no city reaches the level even of 20,000 inhabitants. They range, therefore, at a ratio of three to one, not dissimilar to the four to one ratio in the United States. The slightly wider range in the United States may, indeed, be explained by the particular climatic and economic conditions of the South, where the lowest group is clustered, but the main influence is, as the comparison shows, that of population density.

In complete accord with the conglomeration law, the Hanseatic city-states, offering ideal illustrations of combined state and municipal expenditures in densely populated areas, lead in per capita expenditures in the order of size. They are followed by Saxony, whose population is densest by far among the remaining states. Prussia, covering about three-fifths of Germany, properly is in the middle; Bavaria, considerably less

compilations for the last prewar year and the fiscal years 1925–26 and 1926–27. Ordinances of 1928 and 1931 ordered continued compilation. The results were first published in *Einzelschriften zur Statistik des Deutschen Reichs*, Nos. 10, 14, 16, 17 and 20 (dealing with federal, state and local expenditures for 1913–14 and 1925–26 to 1928–29), later, in *Statistik des Deutschen Reichs*, vol. 387 (expenditures of communes and combines of communes for 1913–14, 1925–26 to 1928–29, published in 1931); *ibid.*, vol. 437 (federal, state and local expenditures for 1929–30, with less detail, and for 1930–31, published in 1933); *ibid.*, vol. 440 (federal, state and local expenditures for 1931–32, published in 1934); and *ibid.*, vol. 483 (dealing with state and local expenditures for 1933–34, publication of a federal budget having been discontinued, and adding summary results for 1934–35, published in 1936). Similar volumes cover local expenditures in the subsequent years. Supplementary notes are found in *Wirtschaft und Statistik*, especially 1929, No. 1, and 1932, Nos. 9 and 24.

TABLE 6

PER CAPITA EXPENDITURES OF STATES AND SUBDIVISIONS OF STATES IN GERMANY, 1928

Rank in Expenditures per Cap.	State	Net Expenditures[a] per Cap. (in *RM*)	Of These Financed by Borrowing (*RM*)	Inhabitants per Sq. Mile	Per cent of People Living in Places of		
					Over 300,000 Inh.	Over 100,000 Inh.	Less than 2,000 Inh.
1	Hamburg	322.42	34	7216	93.6	93.6	1.7
2	Bremen	317.52	66	2836	—	87.1	2.4
3	Lübeck	219.33	43	1117	—	94.6	5.4
4	Saxony	186.70	29	865	26.3	35.2	23.4
5	Baden	171.79	23	398	—	17.7	37.6
6	Hessen	171.11	33	455	—	9.7	37.3
7	Brunswick	170.65	38	355	—	29.4	45.6
8	Prussia	168.21	26	338	25.4	33.7	32.8
9	Mecklenburg-Strelitz	166.38	38	97	—	—	53.3
10	Württemberg	154.26	18	343	14.1	14.1	46.4
11	Mecklenburg-Schwerin	151.94	27	133	—	—	51.4
12	Anhalt	147.20	17	396	—	—	28.7
13	Bavaria	135.02	14	252	14.6	18.3	51.6
14	Thuringia	129.03	22	356	—	—	44.0
15	Waldeck	114.55	26	137	—	—	75.8
16	Schaumburg-Lippe	113.33	17	367	—	—	66.7
17	Oldenburg	108.05	18	220	—	—	18.7
18	Lippe	102.47	13	350	—	—	59.9
	All states and their subdivisions	167.07	25	346	21.7	29.7	34.9
	Federal government	131.73	2	346	21.7	29.7	34.9
	Federal, state and local governments	298.80	27	346	21.7	29.7	34.9

[a] Compiled from *Einzelschrift No. 20 zur Statistik des Deutschen Reichs* (Statistisches Reichsamt, Berlin). The net expenditures were computed by deducting the so-called "administrative revenues" from the so-called "pure financial need." Expenditures financed by borrowing are not here deducted, but their amount per capita is given in the following column. The loans were used in most cases for capital outlay, but sometimes for current expenditures. Whether or not they are included, does not change the picture essentially.

densely settled with more than half of her population living in rural regions, follows farther down. So do other rural sections.

The two Mecklenburgs seem too high on the list. One could regard this as a recoiling of the curve as they happen to be the two states least densely populated.[21] But other factors suffice as an explanation, for instance the fact that these two small states maintained a joint university and court of appeal, separate district courts and other institutions which constituted a relative luxury.

Table 6 is strongly supported by Table 7, which specifies the functional expenditures in five typical states for 1927. The

[21] The likewise sparsely populated little state of Waldeck was abnormal in character because, administered by Prussia, it profited from Prussian institutions such as the two Mecklenburgs had to provide for themselves. Waldeck was soon consolidated with Prussia, while the two Mecklenburgs merged. Hence there is now only one state left with less than 200 inhabitants per square mile, *i.e.* Mecklenburg.

TABLE 7

SPECIFIED PER CAPITA EXPENDITURES IN TYPICAL GERMAN STATES AND THEIR SUBDIVISIONS, 1927[a]

(in reichsmark, omitting parts or rounding them up, if more than half)

State	Per cent of People Living in Places of		Total		Welfare		Housing		Education	
	Over 100,000 Inh.	Less than 2,000 Inh.	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Hamburg	93.6	1.7	364	261	78	59	55	48	58	55
Saxony	35.2	23.4	205	142	44	29	37	22	50	43
Prussia	33.7	32.8	185	131	37	27	25	16	45	38
Bavaria	18.3	51.6	154	110	30	18	16	8	43	38
Oldenburg	—	18.7	133	83	24	15	13	2	37	30
Schaumburg-Lippe	—	66.7	100	77	12	10	6	5	31	27

(Continued)

State	Transportation & Economics		Police		Justice		Finance & Taxation		Miscellaneous	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Hamburg	75	26	23	19	23	13	13	11	38	31
Saxony	23	13	10	9	11	6	15	12	15	8
Prussia	29	16	10	9	10	5	15	13	13	6
Bavaria	21	15	9	8	9	6	13	10	13	7
Oldenburg	25	13	3	3	8	3	12	10	9	7
Schaumburg-Lippe	23	15	3	3	6	2	16[b]	13[b]	3	2

[a] The expenditures are compiled from "Die Deutsche Finanzwirtschaft vor und nach dem Kriege," No. 14 of *Einzelschriften zur Statistik des Deutschen Reichs*, pp. 154 ff., and Arnold Brecht, *op. cit.*, p. 22. Deducted are, in the net expenditures, (1) so-called "administrative revenues," such as fees and fines in justice, tuition fees in education, rates for services; (2) expenses based on borrowing and therefore supposed to be capital outlay, particularly for housing and transportation (highways). Rates for public utilities play no conspicuous part, because most German utilities have the corporation form even when government-owned, so that expenditures do not appear in the statistics on governmental payments.

[b] Expenditures for the Ministries are here included, while subdivided according to functions in the other states.

expenditures for welfare, housing, police, and miscellaneous (the latter post including sanitation) diverge as far as six, nine, seven, and even twelve or more to one respectively, always according to population density. In the fields of education and transportation (the latter including highways) the difference keeps in the limits of two or three to one, while the cost of finance and taxation is hardly affected at all by population density.

In separating the figures for gross and net expenditures this chart shows further that there is no considerable difference in the proportions whether gross or net figures are studied. The same appears from Table 6 regarding capital outlay; whether outlay is added or not hardly affects the result.

It would be interesting to utilize the conglomeration rule also for the comparison of combined national, state, and local expenditures on an international level. From what has been said, it follows clearly that expenditures can be compared between nations only with regard to units of comparable density of population. Such comparable conditions exist between hardly any German and American states. The nearest approach is perhaps between Brunswick and Connecticut, yet even there the comparability is spoiled by the proximity of New York City to Connecticut. In addition, the differences in services and in federal contributions must be considered. In the period from which the present illustrations were taken, reparation payments figured very high in federal expenditures in Germany, while the cost of the army, due to the restrictions of the Versailles treaty, and interest on the domestic debt, due to currency inflation and devaluation, figured very low. Matters were very different in the United States, Great Britain, and France. International comparison of total expenditures must take into account these and many other elements.[22] The cost of individual functions performed by cities of comparable size, however, can be compared more easily.

The foregoing illustrations are meant to suggest the wealth in stimulation and material which can be expected from a systematic cultivation of comparative public administration as distinct from administrative law. One might add similar illustrations regarding such questions as the avoidance of administrative duplications in federal systems;[23] the use made in some states of self-government units in a dual capacity as agencies of the higher levels of government and as independent units;[24] the control and cost problems in relief and public works; gradation of relief rates in various sections of a country; organization of labor camps on a voluntary and conscriptive basis; details of administrative organization, management,[25] purchasing and accounting; selection, training, promotion, etc. of personnel,

[22] The essay cited in note 11 tried to do this, especially for major European countries.

[23] A. Brecht, "Federalism and Business Regulation" in *Social Research*, vol. 2 (1935) pp. 337–352.

[24] A. Brecht, "The New Russian Constitution," *ibid.*, vol. 4 (1937) pp. 157, 186–188.

[25] The monograph on the *Art and Technique of Administration in German Ministries*, quoted in note 2, is especially devoted to these topics.

with more attention paid to details than has so far been the case, *e.g.* regarding examinations;[26] and an indefinite number of similar questions. But a few illustrations will, I hope, prove more stimulating than many vague allusions.

[26] See A. Brecht, "The Relevance of Foreign Experience" in *Public Management in the New Democracy*, ed. by F. Morstein-Marx (New York 1940) p. 107, and "Civil Service" in *Social Research*, vol. 3 (1936) p. 202.

PART II

DEFENSE PROBLEMS AND MISCELLANEOUS

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THE NEW ANTITRUST PROCEDURE AS ILLUSTRATED IN THE CONSTRUCTION INDUSTRY*

Corwin D. Edwards

SUMMARY

THE *significance of the antitrust laws depends to an unusual extent upon the scope of antitrust prosecutions and the policies of the prosecuting agency. The recent enlargement of the Antitrust Division permits, for the first time, use of the laws to reconstruct a whole industry. Housing was chosen as the first case because of the industry's importance, its stagnation, and its chronic restraints of trade. Nationwide prosecutions of restraints at all levels of the industry were accompanied by an effort, largely successful, to win the industry's understanding and coöperation. Tentative lines of policy were developed to clarify both the concept of interstate commerce and the concept of unreasonable restraints of trade. Although few cases have yet been decided, many restraints have been abandoned and in some cases it is clear that the cost of building has been appreciably reduced. Though there is now evidence that antitrust prosecutions can accomplish economic results, they must be enlarged enough to affect more than one industry at a time if they are to safeguard the economic function of competition.*

THE EDITORS

THE antitrust laws have a peculiar character as criminal statutes which invoke court proceedings to accomplish economic ends. To a civil court the cases which come before it are contests between parties, and the decision is a determination of which party shall prevail. Although this view of the judicial process appears most clearly in civil proceedings, it so far influences criminal cases that they too take on the character of limited disputes between the defendant as one party at interest and the government as another such party. An exact determination of the rights of the parties is the aim of the tribunal. To preserve impartiality, the court is protected, as far as possible,

* This study follows out the more general analysis offered in the previous volume of *Public Policy* by A. H. Feller, "Public Policy of Industrial Control." C.J.F.

from popular prejudice, excitement, and wishful thinking about the results of the impending verdict.

But though this is the theory of adjudication, it is not the theory of the social function of law. Indeed, laws are enforced not primarily to punish offenders nor to assert the disputed rights of government, but to induce lawful action by persons who are not parties to the proceedings. Persons not before the court are the ones at whom a trial is directed. An effect outside the courtroom is the principal result to be achieved.

In this social view of law enforcement, the process is much broader than the proceedings. Equality before the law is not conditioned merely upon the impartial character of the tribunal which hears a case, but also upon machinery neither discriminatory nor haphazard in catching law breakers and bringing them before tribunals. The effectiveness of the law in organizing behavior along lawful lines depends upon the consistency with which violators are caught even more than it does upon how the courts treat them afterward. The public interpretation of the law depends less upon the decisions of the courts in the cases which are tried than upon the prosecuting agency's decisions as to what cases to bring to trial. The direction and consistency of prosecuting policy are crucial. The individual case is as unimportant as a single barb in a barbed wire fence.

THE PROSECUTOR'S FUNCTION UNDER THE SHERMAN ACT

For the Sherman Act, as for other criminal statutes, the prosecution determines even more than the judge the law's national impact. But in the case of the Sherman Act, an additional importance is added to the prosecuting function because of the unusual breadth of the statute. The offences which this Act forbids are not specific bits of behavior, like murder or theft, but the creation of an economic relationship of monopoly or the creation of an economic effect of restraint upon trade. These are matters not merely of what a man does, but of the setting in which he does it. Monopoly is never absolute, and the significance of a partial monopoly may differ vastly according to whether or not it is surrounded by other powerful enterprises. Similarly, the impediments to trade can be appraised only in a perspective which distinguishes between those which offset each other and those which reinforce each other. A par-

ticular monopoly or restraint is usually a small part of the economic pattern of an industry and a still smaller fragment of the community of industries whose free competitive performance is the aim of the law. Hence the significance of a case under the Sherman Act is peculiarly dependent upon its relation to other cases. Indeed, the economic background needed in presenting a single case is often so broad that there is difficulty in getting it before a court under rules of evidence which were originally developed to exclude irrelevant matter from ordinary criminal cases.

With so broad a mandate as the prevention of monopolies and unreasonable restraints upon trade, the prosecuting agency not only interprets the law by the scope of its prosecutions, but shares with the courts a broad discretion in working out the law's case by case meaning. Although the courts finally decide whether specific restraints are unreasonable, they do so only in cases brought to them and on issues largely determined by the nature of the indictment. Thus, except for an occasional private suit for triple damages, the prosecuting agency's views about trade determine the issues of legal controversy, and business behavior which the prosecutor regards as proper is exempt from the decisions of the court.

During most of the Sherman Act's half century, the crucial significance of the Antitrust Division in shaping American economic policy has not been understood. The alternatives, politically and economically, were thought to be merely "vigorous" use of the antitrust laws or a willingness to let them go by default, and even the most vigorous policy meant only that a few scapegoat malefactors of great wealth were attacked to provide a symbol of a federal policy oriented against big business. By present standards, vigorous enforcement was impossible for sheer lack of men and money; for the administration of the laws was at first entrusted to the spare moments of United States attorneys and later to a skeleton Antitrust Division which never had enough staff to push more than three or four cases at a time. The idea that the Antitrust Division could check monopolistic tendencies in American economic life was discredited by the Division's obvious inadequacy in size and by the fact that it was obviously fighting a retreating battle. The idea that it could provide constructive aid to the American business system by removing obstacles to traffic did not develop

because such work obviously required a different scale of activity. Although there was a belief that it could serve the consumer, its scattered proceedings necessarily had so little effect upon the market prices of goods that few consumers were conscious of having received any direct service. Under these circumstances those who might risk prosecution thought the laws a nuisance and the rest of the community regarded them as revered traditions which ought to be honored but not allowed to shape modern life.

In spite of the expansion of the last four years, the Antitrust Division's appropriation is still less than that for the Smithsonian Institution, and this sum is obviously not enough to prevent monopolies and restraints of trade throughout American industry. Nevertheless, the growth in personnel has permitted for the first time the development of plan and policy in antitrust proceedings, even though these must be on the scale of one or two major industries at a time. Particular cases are now being instituted and grouped with reference to a central objective. Efforts are being made to summarize the types of restraint which are unlawful, not as a substitute for a close study of each individual case, but as a rough guide to the staff and the public. Questions of procedure are being examined—such matters as to what extent the public understanding obtained by clear announcement of purpose in advance is to be preferred to the greater ease in locating incriminating evidence which is achieved by secrecy about one's plans; and under what conditions a criminal case will be discontinued upon acceptance of a satisfactory decree in equity.

PROSECUTION PLANNED FOR AN INDUSTRY: BUILDING

The first illustration of a planned attack upon the problem of restraints throughout a major industry has been the investigation of housing, begun last year. A description of this campaign will indicate the peculiarities of the new antitrust procedure, its accomplishments, its development of prosecuting policies, and the difficulties which it must face.

The selection of the building industries as the first field for coördinated prosecution was not haphazard. The laggard recovery in construction and in the industries supplying construction materials has been a major source of unemployment and a major drag upon national prosperity. The problem has

been particularly acute in the field of residential building. Here there is a clear national need for more housing and particularly for low-cost housing. It is estimated that 16 per cent of the families in the United States live in dwelling units unfit for human occupancy. According to estimates of the United States Housing Authority, a continuation of residential building at the average rate of the last ten years would supply only about a quarter of our minimum needs for housing during the next ten years. In recognition of this need, the federal government has provided substantial subsidies for low cost housing projects, and has revolutionized the cost of mortgage money through a system of federally guaranteed loans. Yet in spite of this public support, the volume of residential construction is today less than half as great as at its pre-depression peak.

A principal reason for the lag in residential construction is its high cost. The Commissioner of Labor Statistics recently estimated before the Temporary National Economic Committee that about half of the American people cannot afford either to rent or to buy houses costing more than $4,000. This estimate is confirmed by the results of the consumption study recently completed by the Bureau of Labor Statistics and the Bureau of Home Economics, for that study indicates that nearly 55 per cent of American families have annual incomes of less than $1,250 and that the most prosperous quarter of this group spend, on the average, only $203 a year for housing, slightly more than half the commercial rental of a $4,000 house. Yet in 1936, the same year upon which these computed expenditures are based, only 15 per cent of the houses built were intended to sell for as little as $4,000. Thus the problem of inadequate housing, and most of the problem of revival in residential construction, turns upon the gap between housing costs and ability to pay. Unless the incomes of half the American people can be substantially raised, the problem cannot be solved except by a sharp reduction in the cost of a completed structure or by a public subsidy to cover a large part of this cost.

Although the complex factors retarding revival in the construction industries include many which obviously cannot be controlled through the antitrust laws, it is notorious that among these factors are many price-raising and cost-raising restraints of trade. About 25 per cent of all the antitrust cases instituted by the government since 1890 have dealt with the construction

industries or the industries producing or handling building materials. Complaints received by the Antitrust Division in the last few years indicate that restraints are still prevalent. An attack upon these restraints appears to be a necessary part of federal policy; for even if the problem of low cost housing is to be dealt with primarily by subsidy, a check upon price fixing conspiracies is required to translate the subsidies into a large volume of housing rather than into enhanced prices.

Whereas an isolated antitrust proceeding must start with a check upon the accuracy of the particular complaint which gave rise to the inquiry, this investigation began with an analysis of the character of restraints which affect the costs of residential construction and with an effort to determine their relative importance. Since housing is the joint product of many materials and many crafts, it was evident that to produce an appreciable effect upon building costs by removing restraints a comprehensive attack upon restraints throughout the industry would be required. This involved joint investigation of all important crafts and materials. To cover restraints at successive stages of the industry required investigation of manufacture, wholesale and retail distribution, contracting, and labor activity in the construction trades. Since many of the restraints are carried on by local groups, separate investigations in major cities throughout the country were necessary in order to cover the national market. For the maximum effect upon the industry, simultaneous prosecution of all restraints was desirable.

The housing investigation began, therefore, with eleven grand juries sitting simultaneously in cities from New York to Los Angeles and from Chicago to New Orleans. But it was evident from the beginning that even investigation on this unprecedented scale could not bring all law-breakers into court. As in all law enforcement, a primary purpose of the prosecutions was to induce those not prosecuted to obey the law. Since building restraints were widespread and in many cases had been long established, the overthrow of a tradition of restraint was required in this industry. Moreover, since each group in the industry could tell itself that its own particular collusive devices have no great effect upon the total cost of a house, there was need to arouse the imagination of those concerned to an awareness of the cumulative effect of their actions. The accomplishment of these purposes made it imperative that the

industry understand from the beginning the nature of the practices which were under attack and the effect of these practices upon costs.

Publicity thus became a necessary weapon of the investigation. Prosecutors, anxious to avoid the destruction of incriminating documents and the intimidation of witnesses, usually wish to keep their plans secret until they are ready to indict. Nevertheless, a summary of the unlawful restraints in building and of the groups engaged in each of these restraints was made public at the beginning of the building investigation, and was thereafter given the maximum possible publicity by speech and interview. Newspaper men and magazine writers were given unusually complete information about prosecuting plans. Speeches were made before groups in the building industry at every opportunity. Each speech emphasized the need for lower building costs, the nature of building restraints, the way in which these restraints raised costs, and the necessity of dealing with all restraints simultaneously in order to produce a large enough effect to influence the volume of construction. Public statements carefully avoided any imputation of blame to groups in the building industry, and indeed emphasized the view that in an industry ridden with restraints it is difficult for any group to avoid collusion in self-defense. The economic effect of restraints and the economic opportunity offered by low cost housing were stressed as incentives for the industry's coöperation.

LINES OF POLICY

To harmonize the various parts of the building investigation it was essential that at least tentative lines of policy be established both as to the extent of federal jurisdiction over local practices and as to the kind of practices which would be prosecuted. There has been in recent years a strong tendency in the courts to recognize that the field of interstate commerce is broader than would have been formerly conceded. Under older decisions there was no doubt that the federal government could successfully prosecute efforts to restrict the market to local materials by boycotting materials shipped across state lines and efforts to fix prices of commodities to be sold in interstate commerce. To varying degrees, however, it was uncertain to what extent the interstate character of the operations of a

business enterprise might establish federal jurisdiction even though in each state the enterprise used only materials locally made; to what extent the government could prevent local price-fixing of materials which had the effect of limiting their local use and thereby limiting their shipment across state lines from their points of origin in other states; to what extent the government could prevent local price-fixing for services rendered locally when the effect of this price-fixing was to raise the total cost of a building operation and thereby to discourage the use of materials shipped across state lines; and to what extent wasteful practices likely to raise costs could be regarded as under federal jurisdiction because of a similar tendency to limit building and thereby limit commerce in building materials. For some of these questions there were few precedents and for others the precedents were conflicting. The policy adopted was to prosecute restraints locally imposed upon the price or use of building materials wherever, by raising costs, these restraints had the effect of limiting the interstate shipment of such materials, but not to prosecute price- or cost-raising restraints upon materials and services which did not move in interstate commerce if the interstate effect of these restraints was limited to a probable reduction in the interstate shipment of commodities used jointly with the commodity or service subject to restraint. Thus if building sand is produced and used entirely within a state and is subject to local price-fixing, the fact that this restraint, by raising the price of cement work, limits the amount of cement imported from other states is not regarded as sufficient to establish federal jurisdiction. Because of adverse precedents it was decided not to proceed with cases in which the business enterprise takes contracts in more than one state but on each contract the commodities used are all local. Because of these limitations certain restraints with a severe local effect have not been federally prosecuted, and though they have been brought to the attention of local authorities there have been few cases in which a vigorous enforcement of state antitrust laws could be used to supplement federal action. Thus under the present prosecuting policy the effectiveness of federal law is still limited by a concept of commerce as a physical movement of goods across state lines rather than as a network of interstate pecuniary relationships. The case-by-case method through which prosecutors and courts map new legal frontiers forces

us to disregard important factors which limit the volume of housing, even after the stagnation of the housing industries has been recognized as a major national problem.

In deciding what restraints were to be prosecuted, the Antitrust Division could rely upon many precedents. It was clear that collusive price-fixing and boycotts designed to shut competitors out of the market were unlawful. The difficulties in such cases consisted merely in determining whether the complicated activities of various industries actually had the intent and effect of accomplishing such results. This issue was most frequently raised in the case of bid depositories. Some schemes by which contractors filed their bids in advance were frankly designed as machinery for collusive agreements. In other cases, however, the ostensible purpose of the bid depository was merely to give contractors information about bids by their competitors subsequent to the opening of the bids and to enable them to discover whether the contractor receiving the award had reduced his original bid. In these cases it was argued that the device was merely informative. Nevertheless, such plans were regarded as subject to prosecution if it appeared that they had actually intimidated contractors who might wish to revise their bids or if the result had actually been a tacit understanding that the level of bids would be raised.

The Antitrust Division's policy toward bid depositories was recently expressed in a letter to a secretary of a chamber of commerce who inquired concerning the legality of such plans. The depositories in which he was interested were designed to keep bids secret until after they had been opened by the awarding authority and therefore avoided the obvious collusion which accompanies prior inspection of a competitor's bid. The Department's comment ran as follows:

> Regardless of the means employed, a combination of business competitors to take joint action to raise prices or to harass or coerce certain specified competitors is a restraint of trade which is unlawful if it directly affects commerce. Such unlawful activities have been typically involved in bid depositories which have come to the Department's attention. When, as in your proposed depositories, the bids are not opened until after their opening by the awarding authority there usually is an intent to require all bidders to use the depository and to prevent bidders from revising their bids at their own discretion. When such plans operate effectively they are usually

associated with forms of coercive pressure against contractors who do not use the depository and against contractors who do not abide by the tacit agreement to avoid revision of bids. In most cases these indirect devices appear to have operated as conspiracies to raise the level of bids, and in some cases their effectiveness has been as great as that of a direct conspiracy.

The Department is not prepared to say in advance that a bid depository must necessarily involve the kind of restraint forbidden by the antitrust laws. Since, however, the Department's experience indicates a high probability of unlawful restraint in such schemes, the Department must reserve complete liberty of action to proceed either criminally or civilly against any bid depository which seeks to prevent revision of bids or which provides for systematically identifying to competitors the name of each bidder who makes a low bid or who revises his bid.

There were, however, certain fields of business action in which the meaning of the antitrust laws had not yet been spelled out in court. One of these fields was the use of patents and patent licensing agreements. Here it was necessary to determine the extent of the monopoly powers conveyed by a patent and the extent to which various patents might be jointly used to establish a control in the market greater than could be achieved under any one of them singly. Since most of the cases involving patents are still under investigation, the prosecuting policies of the Division in this field cannot yet be publicly summarized.

A second problem arose concerning the extent to which systems of so-called *del credere* agencies may be used to establish control in a market. In a suit against the Masonite Corporation the government contends that contracts which actually deprive the so-called agent of most of the risks and responsibilities of ownership are not in fact agency contracts and that even bona fide agency contracts may not be used systematically to bring all actual and potential competitors in an industry under a single control. The existence of such a control is alleged in the sale of hardboard, substantially all of which is manufactured by the Masonite Corporation.

The most conspicuous field in which policy-making was necessary was that of the activities of building trades unions. The trend of public policy during the fifty years of the Sherman Act has been toward an increased scope for union activity. In 1914

the Clayton Act specifically protected the existence and legitimate activities of unions. Although subsequent to the Clayton Act unions were still successfully prosecuted for violence in labor disputes and for secondary boycotts designed to force recognition of the union, such cases have been rare in recent years. Moreover, the policy of Congress, as expressed in the National Labor Relations Act and in the Norris-LaGuardia Act, was obviously to foster labor organization and to limit judicial proceedings which might interfere with it. In the light of this history it was peculiarly necessary to formulate, if possible, the rule of reason applicable to labor unions.

The Department's policy in labor prosecutions was publicly announced in a letter to the Secretary of the Central Labor Union of Indianapolis. Refusing to prosecute breaches of the peace incidental to strikes, the Department expressed the view, subsequently incorporated in the Supreme Court decision in the Apex case, that the antitrust laws are not properly used as a substitute for local police activity. In spite of Supreme Court precedents the Department also determined not to prosecute secondary boycotts conducted in an effort to secure recognition of the union or the establishment of satisfactory wages, hours, and conditions of employment by the producer. Thus the immunity of unions which had been tacitly established by prosecuting policy in the past was explicitly recognized.

Five types of labor restraint were specifically defined as subject to prosecution. Of these, four had been consistently prosecuted in the past, so that as to them the announcement merely recognized a long established policy. They were (1) participation by unions in business plans to fix prices, (2) restraints of trade designed to enforce systems of graft and extortion, (3) efforts to compel the hiring of useless and unnecessary labor, and (4) efforts to prevent the use of improved materials, equipment, and methods. Although certain union leaders professed indignation and argued that all union activities are exempt from the antitrust laws, the precedents in such cases were so clear that it was generally recognized that the union contentions were based not upon what they believed the law was but upon what they believed it should be.

The fifth type of union activity against which the Department decided to proceed was the use of unreasonable restraints

to destroy legitimate and established systems of collective bargaining. Among the building trades unions such restraints have been frequently invoked during jurisdictional disputes. Until the labor movement recently divided into two rival labor federations, each union involved in such a dispute recognized that the other had a legitimate field of operation but disagreed as to the allocation of particular work. Although the American Federation of Labor endeavored to settle such disputes through its building trades department, strong unions often refused to accept the award or mediation of that department and resorted instead to strikes, boycotts, and violence. These jurisdictional fights had been an important influence in raising building costs, but at any one time their effect had been limited to a few trades and localities.

With the rise of the rival labor federations, inter-union warfare became a far greater problem. In disputes between the federations each union denies the legitimacy of the other and claims substantially the entire field for itself. Through the alliances of unions within each federation such disputes often spread by sympathetic strike until they may readily tie up a whole metropolitan area. Such developments forced the jurisdictional dispute into the Department's program.

The Department took the view that argument, rival organization campaigns, and use of the established machinery of the National Labor Relations Board and of the American Federation of Labor involved no unlawful restraint of trade in the conduct of a jurisdictional dispute, but that to stop building or to interfere with the flow of building materials in order to substitute one legitimate union for another was to expose the community to a paralysis of activity from which it could not readily escape, since any settlement satisfactory to the one union would necessarily provoke warfare by the other. Such restraints were regarded as violations of the antitrust laws. The legal questions involved are now pending before the courts. The Department believed, however, that unions themselves would gradually come to advocate the Department's interpretation of the law in recognition of the fact that the labor movement stands to gain nothing by internal strife but may gain much if its own orderly processes for settling internal disputes are protected against sabotage by recalcitrant unions.

WHAT HAVE THE PROSECUTIONS ACCOMPLISHED?

The breadth of the prosecuting program in the building industries will permit a rapid test of the legal adequacy and economic effect of the policies just described. On October 31st federal grand juries investigating building restraints had returned 99 indictments against 1569 defendants; in addition 18 consent decrees had been entered against 367 defendants and 1 contested equity decree was awaiting trial. Among manufacturers the Southern Pine Association had been fined after deciding not to contest charges of fixing prices and attempting to shut competitors out of the market; Western Pine Association, West Coast Lumbermen's Association, National Association of Lumber Manufacturers, and various business enterprises and individuals had been indicted on similar charges affecting the sale of Western pine and Douglas fir; the Masonite Corporation was to be tried for price fixing; and manufacturers of gypsum products had been named as defendants in two criminal indictments and a civil suit. Among distributors electrical supply companies and dealers in lumber and hardwood flooring had been indicted for price-fixing. Among contractors proceedings against price-fixing had been undertaken in various cities in the electrical, plastering, hardwood flooring, sheet metal, mason and tile, excavating, plumbing and heating, painting, and marble trades and also among electric lighting fixture producers and general contractors. Indictments had been secured against groups trying to shut their competitors out of the market in the electrical, cut stone, glazing, millwork, sheet metal, tile, heating, piping and air conditioning, trucking, and plumbing trades. Sometimes these efforts were to preserve the market for local competitors as against those from outside the town or state, sometimes for trade association members as against independents, and sometimes for the orthodox distributors as against direct selling houses, mail order houses, or other concerns trying to do business in a new way. In one case union officials and local unions had been indicted for attempting to prevent the use of ready-mixed concrete in a Middlewestern city. At the end of October only one contested case had come to trial, and in it the judge had dismissed the proceeding on the ground that there was not adequate evidence of the intent of the defendants. The effectiveness of the prosecutions in punish-

ing law-breakers was still to be determined by the subsequent trials.

The economic effect of the proceedings is being felt, however, even before the cases reach the courts. An outstanding effect has been an intensification of the desire of groups in the building industry to eliminate restrictive practices. The reaction of the building industry and of the public to this investigation has been unique in the experience of the Antitrust Division. In the past, the members of an industry in which there was an antitrust investigation have usually been hostile, and relatively few antitrust cases have been enthusiastically received by the general public. By contrast, the building investigation has received enthusiastic support both from the public and from most groups in the industry itself. The American Institute of Architects, The National Association of Real Estate Boards, and Associated General Contractors have officially endorsed the investigation. Subcontracting groups and the trade journals which represent them have very generally given sympathy and support, although the organizations in the plumbing trade have been suspicious or hostile from the beginning. Though manufacturers and distributors of building materials have generally avoided public statements, many of them have privately extended sympathy and coöperation. Many building groups have voluntarily abandoned their restrictive practices. Many letters endorsing the investigation have been received from the rank and file of building trades unions and from labor union officials. Although the national offficals of the American Federation of Labor have been sharply critical of the investigation, there is reason to believe that some of them are attempting to eliminate unlawful practices among local branches of their unions.

This unusual support from the building industry is directly related to the scope and technique of the investigation. Isolated proceedings like those to which the Antitrust Division was limited in the past would have received no such welcome. In spite of their formal observance of due process of law, such proceedings would necessarily have been confined to so few culprits that punishment would have seemed discriminatory persecution. Since these isolated cases would have done nothing substantial to reduce building costs, they would have served no significant public purpose, and would have offered the industry no prospect of operating at lower costs in a wider market.

For lack of economic purpose, they would necessarily have been defended on moral grounds; and neither the defendants nor the rest of the industry could have been persuaded that the prosecutions had caught unusually bad people. By contrast, even building groups which are themselves engaged in unlawful restraints would usually welcome a general liberation of the industry from such practices, and those which are reluctant toward such a change are none the less aware of the public need for it.

The willingness of many groups in the building industry to abandon cost-raising restraints before they are convicted in court and often even before they are investigated has made possible a substantial reduction in building costs even at this early stage of the prosecuting program. Since the Department is not equipped for an extended statistical study, it does not know the aggregate reduction in costs in the cities in which it has conducted investigations nor the extent of the area around those cities in which similar reductions have occurred. It is aware, however, of specific cases in which substantial reductions have been achieved as a direct result of the prosecutions. One of the most striking of these is in Pittsburgh where a low cost housing project has been developed in two units. On the first unit bids were opened before the Department's investigation began. On the second they were opened December 22, 1939, after a federal grand jury had been concerned with building for about three months. The bids on the second unit were consistently lower than on the first. On the electrical contract the low bid on unit number 2 was 23½ per cent below that on unit number 1; on the heating contract, 27 per cent below; on the plumbing contract, 26 per cent below; and on the general contract, 12 per cent below. The total cost per family on the second unit will be 17 per cent below that on the first, a reduction of approximately $148 per room. The saving on this one project was about one million, one hundred thousand dollars, or within $200,000 of the entire annual appropriation of the Antitrust Division.

Significant changes in trade practices in the industries producing building materials and erecting houses have developed during the investigation. In February 1940 an indictment of the Southern Pine Association and two related groups included a charge that these groups had sought to restrain trade by

abusing a system of grading, grademarking, and inspection of Southern pine lumber. The government believed that the inspectors employed by the Southern Pine Association had systematically endeavored to find low-quality lumber sold by independents and had given each such discovery the maximum possible publicity but had carefully suppressed the news of substandard lumber sold under the association's grademark. This was believed to be part of an effort to drive independents out of business and to force everyone who produces Southern pine to use a grademarking system controlled by the trade association. It was also believed that the mill's serial number which was included in the trademarked grademark was used to enforce a conspiracy to sell lumber through agreed channels of distribution, since this serial number permitted the identification and boycott of any mill which sold lumber through other channels.

The defendants in this case accepted a decree which reorganized the grademarking system for Southern pine. The grading activities of the association were delegated to an autonomous bureau controlled by a governing body which was to represent all of those who used its service. Grading services were to be available to non-members of the association without discrimination in service or charge and without any requirement that independent manufacturers support the other activities of the Southern Pine Association. The staff engaged in grademarking were not to promote the interests of the association or of any individual manufacturer. It was hoped that this reorganization would eliminate opportunities to manipulate grademarking to serve special interests.

The interest which certain other lumber associations have shown in the Southern pine decree indicates a possibility that the principles of this decree will become the basis for a general reorganization of grading practices in the lumber industry. The decree and the subsequent indictments among manufacturers of Western pine and Douglas fir have focused the attention of manufacturers of building materials generally upon the need to avoid closing channels of trade to competitors by the methods used in identifying the quality of their goods.

Another prosecution has apparently brought about the elimination of bidding fees among general contractors. The New Orleans Chapter of Associated General Contractors was indicted in December 1939 for a conspiracy to defraud the United

States by agreement upon a fee to be charged for the trouble of making a bid and agreement to add this fee, multiplied by the number of bidders, to the amount of each contractor's bid in order that the successful bidder might pay the fee to each of his unsuccessful rivals. In January 1940 the defendants accepted a decree which permanently enjoined any such fee-splitting. The Assistant Attorney General has indicated publicly that this case has been accepted as a binding precedent by general contractors throughout the country and that the movement to include such fees in contractors' bids has come to an end.

Other cases have apparently terminated efforts throughout the country to control the channels for the distribution and installation of tile. The tile industry has been chronically subject to boycotts by manufacturers, contractors, and the union, designed to prevent the sale of tile to jobbers and to any other distributors who may be willing to sell it to the ultimate consumer without requiring him to purchase an installation service also. The intent of such boycotts has been to protect tile contractors who never sell tile as such but include its price in their charges for a tile installation. Between December 1939 and May 1940 indictments were returned against such conspiracies in Detroit, Chicago, and St. Louis. Thereupon the bricklayers' union and the Tile Contractors' Association of America voluntarily proposed a decree intended to do away with the causes for such complaints throughout the industry. Under the terms of this decree contractors may not participate in conspiracies to boycott, or to withhold union labor, or to handicap the sale of unset tile, or to operate a bid depository. The union may not conspire with business men in the tile industry to restrict the sale of tile or the supply of labor, or to bring about boycotts by general contractors. The union is also enjoined from discriminating against any employer willing to observe local union labor conditions when the purpose of such discrimination is to enforce the rules of a contractors' association, or to require the employer to maintain a showroom, or to prevent sales to jobbers, or to exact discriminatory high wages and hours on the ground that the employer pays them in some other locality, or to impose various other exactions which are not related in good faith to a reasonable objective of organized labor. Both the national contractors' association and the na-

tional union are required to prevent violations of the decree by their subordinate local bodies both by punishing such violations in so far as they have authority under their constitutions and by reporting the facts to the Attorney General. Two features of this decree are significant: The fact that it contains the most careful distinction between lawful and unlawful labor practices which has ever been set forth in a decree in an antitrust case, and the fact that it enlists the organized strength of the industry itself to secure compliance with the law.

The most widespread change which has been brought about by the building prosecutions has been the discrediting of the bid depository. Such depositories have been prevalent in the subcontracting trades ever since the breakdown of the N.R.A. The collusive use of bid depositories to raise prices had become so well established that many groups operated such plans openly and sought to encourage their spread. As a result of at least a dozen indictments directed primarily against such depositories, many of these same groups have accepted decrees permanently enjoining the operation of such a device and others have abandoned their depositories without awaiting federal investigation. The cruder forms of bid depository are now completely discredited and great caution has developed in the use of devices less obviously collusive.

In addition to the immediate savings which may be achieved by getting rid of price-fixing conspiracies and by abolishing restraints which impose uneconomic methods upon the industry, it is probable that building costs may be significantly lowered by the encouragement of experimental building. The hazards of pioneering are so great in the building industry, as elsewhere, that men hesitate to take such risks if they must also encounter the additional risk of being attacked by organized gangs anxious to drive them out of business. Experimental builders have told the Antitrust Division, however, that they are prepared to go ahead vigorously as soon as it is safe to do so. Their programs differ widely. Some want to simplify and standardize plans, some want to build houses of standard parts, some want to prefabricate whole walls, bathroom units, or even halves of houses so that construction becomes a mere job of assembly. Doubtless a great many of their ideas are impractical. Nevertheless, there is every chance that in housing, as else-

where, an active program of experiment will uncover enough practical improvements to revolutionize the cost of housing. This seems all the more probable because the experimenters, much as they differ, are all moving in the same general direction—toward a greater standardization of the structural units which go into building, toward increased fabrication in the workshop rather than on the jobsite, and toward a larger degree of centralized responsibility for the soundness of the completed structure. They are moving, that is, along the lines which in other American industries have given us low-cost production for a mass market such as would have seemed impossible a generation ago.

A first step in the protection of the prefabricator was taken in September 1940 by an indictment which charges a conspiracy to prevent the sale of prefabricated houses in Belleville, Illinois. Local building material dealers, contractors, officials of the carpenters' and building laborers' unions, and the chief of police are charged with a series of efforts to prevent the erection of a prefabricated house by concerted refusals to perform the work and by violence to prevent others from performing it. Before the indictment there had been repeated riots at the construction site; thereafter the work proceeded without further violence.

Although the scope of the housing investigation is smaller than would be appropriate but for limitations of personnel, it is still large enough to show for the first time the economic function which can be performed by the antitrust laws. It reveals the possibilities of the laws as instruments of national policy designed to reorganize the behavior of a sick industry in such a way that competition may work.

ONE INDUSTRY AT A TIME IS NOT ENOUGH

Nevertheless, this investigation does not express a national policy toward competition but a mere segment of such a policy. From the point of view of a society which depends upon competition to coördinate most of its industries and keep them efficient, the staggered enforcement of the antitrust laws first in one industry and then in another is not adequate, although it is more satisfactory than enforcement against only one or two concerns within an industry. The inability of consumers to spend more for housing is in part due to the fact that they must

spend too much for other things and that they are denied opportunities for higher earnings by the restrictive policies of other industries. Restraints of trade affect not only houses, but house furnishings, foods, and other major items of the householder's budget. An effective use of the antitrust laws requires more than the elimination of unreasonable restraints from a single major industry while similar restraints elsewhere continue to distort the over-all performance of the economic system.

The experience of the last two years has made clear the usefulness of the antitrust laws for economic purposes by demonstrating that their chief defects are in the scale of enforcement. When men and money became available to plan a prosecution for a whole industry, a constructive result was possible in spite of the limits of federal jurisdiction and the defects in the statute. If men and money were provided sufficient to permit enforcement of the laws throughout the area in which the nation relies upon competition, the Antitrust Division would have to face for the first time many broad questions of prosecuting policy which are now irrelevant to its scale of work. The change in scale would automatically pose the problems. But the possession of resources adequate to the job would be the indispensable first step in finding the answers.

THE HISTORICAL AND COMPARATIVE BACKGROUND OF THE HATCH LAW

Otto Kirchheimer

SUMMARY

ALTHOUGH *the idea that certain offices should not be held simultaneously by the same person is as old as the Canon Law, no general rule for the application of this principle has yet been worked out by modern governments. Ever since the Act of Settlement, efforts have repeatedly been made to prevent legislators from occupying administrative and judicial posts, to prevent them from taking advantage of their official position to promote their personal business interests, and to prevent them from acting as the tools of particular industrial and commercial enterprises. Today, with the growing interdependence of government and business, with the rise of monopolies in certain fields, and with the increasing tendency for political parties to form along economic lines, attempts to distinguish between purely private (and therefore unrepresentable) business interests and the general professional interest of an entire industry appear unrealistic.*

While the question has at times been raised whether the active participation of administrative officials in legislative assemblies might not be desirable, such participation would destroy the political neutrality of the official. It is at the preservation of this neutrality that the Hatch Act is in part aimed. National, state, and local officials who receive payment directly or indirectly from the federal government are forbidden to participate in organized political activities, although they may defend their own policies and express their own opinions as individuals. This elimination of officeholders from the predominant position in party councils foreshadows increasing fierceness in party strife as attention is focused upon divergent policies rather than a struggle for offices.

An efficient administration must prevent its officers from basing their decisions upon personal interests or using official knowledge for private advantage. Similarly, it should create a central agency to determine whether and under what conditions government employees may seek private employment, when their official experience and contacts may be turned to private interest. While the voluntary acceptance by officials of a high standard of personal conduct would be the most effective preventive of such practices, the increasing concentration of governmental power makes it necessary for democratic nations to clarify further the

boundary line between the pursuit of private gain and the tenure of public office, between culpable and permissible conduct.

THE EDITORS

THE legal conception of incompatibility, which derives from the Canon Law, means that certain offices or positions cannot be held simultaneously.[1] The *Codex Juris Canonici* gives a general reason for the introduction of incompatibility between different offices when it says: *sunt incompatibilia officia, quae una simul ab eodem adimpleri nequeunt.*[2] The idea at the root of this legislation is that one man may not have sufficient strength to perform several functions satisfactorily.

The constitutional and administrative practice of modern states took over this conception but did not develop a general principle of applying it. The holding of several official positions, or the pursuit of certain private or semi-private professions while filling positions of public trust, was forbidden from time to time. Aversion developed at a rather early date to the lawyer who, under the guise of representing the people, furthered his own private interest or that of his clientele. Radical pamphleteers of the seventeenth century had strong opinions on this point, and the "Agreement of the People" explicitly states: "In case any lawyer shall be chosen into any Representative or Council of State, then he shall be incapable of practice as a lawyer during the period of said trust."[3] The idea that the lawyer should be forbidden to practice while sitting in Parliament was never completely put into effect in the history of parliamentarism. But at the same time uneasiness about the lawyer's double role as representative of the public at large and of definite private interests never disappeared. We shall have to come back to these questions later.

EARLY RESTRICTIONS ON LEGISLATORS

It has been a consistent rule of English legislative practice, ever since the Act of Settlement, to forbid members of Parliament to hold administrative or judicial office. The federal

[1] Conc. Trid. sees. 7, de reform. cap. 4. G. Phillips, *Kirchenrecht* (Regensburg, 1869), vol. 7, 1, pp. 454 ff.
[2] Can. 156 § 2 C.J.C.
[3] S. R. Gardiner, *The Constitutional Documents of the Puritan Revolution, 1625–1660*, 3rd revised edition (London, 1936), p. 365.

constitution of the United States imitated this prohibition in its sixth article which states, "No person holding office under the United States shall be a member of either House during his continuance in office." This was intended to free debate from any influence of the executive. Moreover, freedom of parliamentary discussion, it was held, would be endangered not only if executive officers were permitted in the legislatures but also if members were to allow their votes to be influenced by special privileges granted them by the government in exchange for favorable votes. The English legislation of 1782 and 1801 was consequently directed against just these pernicious practices which were found to be corrupting the members.[4]

Early American legislation was also concerned with the problem of contractual relationships between members of Congress and the government. It forbade officials to enter into any contract, bargain, or agreement with members. The statute declares such contracts to be void at the outset.[5] But the value of these rather strict rules is doubtful in the light of the generous exemptions granted in another section of the same statute. The statute seeks to establish a distinction between the forbidden personal interest of a member of Congress in a government contract and an admissible general benefit through the company or corporation in which this member has an interest.[6] An early opinion of the Attorney General, in analysing these provisions, laid emphasis on the prevention of executive influence on the legislature and therefore favored a rather broad interpretation of personal interest.[7] Later opinion, however, deviated from this interpretation. In 1842 the Attorney General approved a contract made by a business firm in which a Congressman was one of the partners. He ruled that a contract is rendered void by an immediate personal interest in the profits and not by ultimate profit accruing to him.[8] Later opinions have followed this line. A more recent opinion, signed by Mr. Daugherty, did not object to a loan by a government corporation to a cattle financing company whose promissory notes

[4] 22 Geo 3, c. 45; 41 Geo 3, c. 52. On the activities of lawyers, merchants, and bankers in Parliament in the eighteenth century see L. B. Namier, *The Structure of Politics at the Succession of George III* (London, 1929), vol. I, pp. 53–72.

[5] 35 Stat. 1109, 15 U.S.C. 204, 205. As regards the construction of these provisions compare *U. S. v. Dietrich* (C. C. Neb.) 1904, 126 F. 671.

[6] 15 U.S.C. 206.

[7] 2 Op. Atty. Gen. 38 (1826).

[8] 4 Op. Atty. Gen. 47 (1842).

were secured by a note of another cattle company in which a Senator had a minority interest.[9]

INADEQUACY OF MODERN RESTRICTIONS

In our time it is no longer necessary to secure freedom of parliamentary deliberation through such methods. The disqualification of members of deliberative assemblies now aims primarily at preventing members from taking unfair advantage of their official position. The effectiveness of these provisions, even where no narrow statutory construction prevails, has not been too far reaching, as can be seen from the working of Great Britain's Local Government Act of 1933. That Act requires councillors who have a direct or indirect relationship with businesses engaged in government contracts to make the relationship public or pay a fine of not more than £50. But two years after this Act went into effect a mass of proof was brought forward indicating that English local government was honeycombed with corruption.[10]

But the major cause of the inadequacy of this legislation lay not in the difficulty of securing effective enforcement in all cases, nor in the fact that statutory exemptions were granted.[11] It resulted from its being restricted to contractual relationships. The question today is not whether members of legislative assemblies may make personal gains through government contracts granted to them or to their associates, but to what extent they may be allowed to serve private interests at all. Even where no contractual relationship and no question of personal

[9] 33 Op. Atty. Gen. 44 (1921).

[10] See the well-informed articles of W. E. Clough, "Corruption in Government," *Nineteenth Century*, 1935, pp. 591–604, and 1936, pp. 174–186. The opposite view held by W. Ivor Jennings, "Corruption in the Public Service," *Political Quarterly*, January/March, 1938, p. 46 "that local Government is remarkably free from corruption" seems unsubstantiated. A list of the European countries which introduced similar legislation is found in W. Weber, "Der Ausschluss wirtschaftlicher Unternehmer vom Parlament," *Festgabe für die Berliner Handelschochschule*, 1931, pp. 113–140, where the problems of the exclusion of entrepreneurs from legislative assemblies are discussed. Weber's article "Parlamentarische Unvereinbarkeiten," *Archiv des oeffentlichen Rechts*, Neue Folge, 1930, vol. 19, pp. 161–254, discusses the problem of parliamentary incompatibility in general.

[11] As regards Great Britain see: 21 Geo 5, c. 13 (1931). Sir Stafford Cripps, when Solicitor General, in moving the bill (Hansard, vol. 250, pp. 361–65) limited his discussion to the technical question of the nuisance of individual indemnity bills in the trivial case where a house owned by a member of Parliament might be leased for a Post Office or a similar use. The statutory exemptions from the restriction placed upon members of Congress by 18 U.S.C. 204 are enumerated in 18 U. S. C. A. 206 (supplement 1939) and Op. Atty. Gen. of Dec. 24, 1939.

gain is involved, the ever growing interdependence of private business and public administration has brought to the fore the question of which private interest a legislator may serve without impairing the fulfillment of his duties. The fact that he represents not the nation as a whole but his party had to be more or less accepted, although several nice legal questions presented themselves when Burke's dictum was abandoned. That he represents definite social interests had to be accepted, too. Several European countries tried to define the cases in which membership in Parliament and the pursuit of private business activity were to be held incompatible. They attempted to restore freedom to political institutions by protecting the representative's political independence from his own economic ties. Such attempts usually followed upon the disclosures of public scandals. Each one of the statutes that resulted shows the mark of being an *ad hoc* act of legislation brought into existence to quiet public opinion.

The Czechoslovakian statute of 1925, for example, which followed the discovery of a scandal in which the President of the Senate was involved, requires that the office of the President of the Senate or of the Chamber should not be combined with membership on the board or the management of a corporation or company of a commercial character.[12] But for the most part this statute, like a similar Austrian one that was passed after the collapse of agricultural banking institutions, does not declare that membership in Parliament and participation in certain forms of business activity are incompatible. It merely places the power of applying the rule in the hands of parliamentary committees.[13] A Czechoslovakian Senator and Professor of Public Law, who has had some experience with such committees, called them an "outlet for corruption and a public whitewash for the members."[14]

The interposition of parliamentary committees, however, is not the only basic weakness of such endeavors, as is shown by the French example. More than fifteen resolutions on the subject occupied the legislative assemblies of France before 1922, but it was only after the scandal of the *Gazette de France* in 1928 that any attempt at comprehensive legislation was made.

[12] Gesetzessammlung 1924, No. 144, p. 958. See also the remarks of Ludwig Adamovich, *Grundriss des tschechoslovakischen Staatsrechts* (Vienna, 1929), p. 324.
[13] *Austrian Bundesgesetzblatt*, 1925, p. 294.
[14] Spiegel in Bohemia, No. 82, April 5, 1924.

Legislators were not to be affiliated with corporations receiving direct subsidies from the government. In all other cases the application of the statute was restricted to corporate enterprises in the sphere of finance, and then only if the position held by the legislator was obtained after his election to the assembly. In the latter case he had to give up his seat. He could run for reëlection, however, because his reëlection was supposed to imply that the voters granted him an exemption from the statutory disqualification.[15]

The very idea on which this legislation is based proves it to be framed without consideration for recent social changes. At first the distinction which the French statute makes between subsidized and independent enterprise may have been important under the conditions of the pre-World-War economy, but it scarcely means much under the incipient state capitalism of our day. Secondly, the fact that the law forbids legislators to accept certain commercial positions only after their election shows that it is aimed at interests which hope to obtain advantages through putting a deputy or senator on their payroll. But the problem of our day is not mainly that of the successful individual politician who, having established himself in Parliament, tries to make money by selling his influence to private interests. The *deputé d'affaires*, as such a figure is called in France, always has existed and probably will exist as long as representative institutions endure—only to be replaced, where they disappear, by the influential party member with the best connections. The man who becomes a director, chairman, or adviser of a corporation because he is a member of a legislative assembly is becoming less typical in our time than the reverse situation of the man who becomes a member of such assemblies because he has a leading position in the business world.[16] The more the system of proportional representation has advanced and the more political parties have been formed on economic lines the more apparent this tendency has become.

It is therefore no coincidence that in Germany, where both conditions were present, the senselessness of this practice of disqualification became quite evident. In 1927 certain deputies

[15] The text of the statute in *Journal Officiel* (1928), p. 13666. See also R. Michel, *Dés incompatibilités parlamentaires en matière de sociétés* (Paris, 1929), and Joseph Barthelémy and Paul Duez, *Traité Elementaire de Droit Constitutionel* (Paris, 1933), pp. 597 ff.

[16] See W. I. Jennings, *Parliament* (Cambridge, England, 1939), p. 31.

in the German Reichstag took a decisive part in the debate on the introduction of a monopoly for matches when they were closely connected with the corporation seeking the monopoly. As a result of the incident a number of motions were introduced, though without practical results. These motions are interesting for two reasons. In the first place they did not attempt to stop the infiltration into legislative assemblies of representatives of economic organizations. Rather the bill simply attempted to force the member to make his economic affiliation public. In the second place there was an attempt to differentiate between an improper private business interest and the recognized interest of an entire industry.[17] But, granted for a moment that a distinction is possible between the professional interest of a whole industry and the individual interest of the single corporation,[18] as long as representative institutions have a territorial rather than a functional basis, it is difficult to see how the special interest—for instance, a particular banking institution or shipbuilding corporation—could be prevented from putting up business associates as candidates in a local election.[19]

Is the assumption, however, that a general professional or group interest and a special private business interest can be separated still true in our time? Does not the rapid growth of monopoly in contemporary society defy any attempt at such a line of demarcation? Take for instance the parliamentary history of the defunct German Republic. Did Dr. Hummel, who was elected to the Reichstag on the Democratic party ticket to represent the I.G. Farben Industrie, the dye trust which came very close to holding a complete monopoly in the chemical industry, represent a particular corporation or a legitimate group interest? It is almost impossible to draw a definite line of demarcation between a legitimate group interest and private business interest. For this reason, all attempts to restrict representation of economic interests in legislative assemblies are doomed to failure. This is especially true when the

[17] See W. Weber, "Der Ausschluss . . .," pp. 128–9.

[18] Section 2 of the above mentioned Czechoslovakian statute for instance admitted that a member could be director of a corporation if the advantages granted to his enterprise were of a general nature and did not contain special privilege.

[19] Much spade work has been done, especially in England, within the last few years to establish the close affiliation of parliamentarians with economic interests. Besides Jennings, *op. cit.* see, for the nineteenth century, J. A. Thomas, *The House of Commons, 1832–1901* (Cardiff, 1939) and for the twentieth century S. Haxey, *Tory, M. P.* (London and New York, 1939). Haxey examines in considerable detail the economic affiliations of conservative members.

business and sectional interest which the member represents are closely related. The member may be bound to these interests by special ties; he may be their permanent counsel, he may be chairman of the corporation or on its board of directors; he may be an active secretary of a union or, if the union charter prohibits his seeking office, he may be a superannuated union official who is being "pensioned off," as it were, to Parliament. Or he may simply get his seat through the backing of these interests. But the difference between holding a position in a corporation or a union and receiving their political backing is more important from a legal or propagandistic point of view than it is in any concrete or factual way. And, of course, there will always be border-line cases in which personal advantage accrues to the political figure even if the main object for which he exercises pressure is of a broader nature. The sense of the word "corruption" is rapidly changing its meaning in our day. We speak of the disappearance of "personal" in favor of "impersonal" corruption, meaning that the parliamentarian deviates from the vote his conscience would urge him to cast, not for his private advantage but in accordance with the orders of the economic bloc with which he is tied up. If his allegiance to economic groups is called corruption, his act only reflects a prevailing condition in our society. He deviates from the ideal representative no more and no less than we all deviate from the ideal voter when we cast our ballot with the advantage of our trade, profession, and class in mind.

THE LAWYER AS LEGISLATOR

But let us return for a moment to the older forms of political "corruption" which are still of major importance in the field of local government and of some importance in national legislatures. Besides the already discussed attempts to prohibit personal profiteering through government contracts we should say a word more about the deputy lawyer, banned by the "Agreement of the People," yet very much alive under the traditional parliamentary set-up. It is no accident that the problem has been much discussed under the Third Republic of France, where lawyers were the dominant professional group. In so far as the lawyer represents a major economic interest which he serves consistently to the exclusion of other interests, the problems of his position are the same as those of all other

members permanently representing important economic interests. But in so far as the lawyer is retained only for specific cases, the problem changes. A client must have a substantial backing in the community at large, his interest must appear to be worthy of protection to many disinterested members of the legislature if a legislator is to succeed in passing or killing a bill for him. Only in rare instances, therefore, will the lawyer-member be able to influence legislation to any considerable extent to the profit of his client. His main concern will be with administrative and judicial facilities for adapting the laws to the needs of his clientele.[20]

The failure of the French legislation of 1928 to include measures to prevent this kind of pressure was clearly shown by the events following the Stavinsky scandal of 1933–34. Even after public indignation had forced certain remedial steps there was no disbarment of lawyers who held seats in Parliament. Only certain branches of legal activity, such as pleading in criminal trials of a financial character and representing civil parties in suits against the government, were closed to them.[21] André Hesse, one of the Stavinsky lawyers, could still defend the right of a lawyer in Parliament to represent *ad hoc* interests in almost the same language used by an English colleague of his seventy-six years before:

> You have no right to reproach an attorney who practices his profession. I see no harm in taking up the question of parliamentary incompatibility, but I do not think that it applies only to lawyers. It would be necessary to have done with all deputies. I shall tell you why: People might suspect the merchants, the industrialists, the engineers, of having an interest in sitting on committees on the tariff, on trade, on public works. Politics will become a profession but it is necessary to be brave and logical. The day that you forbid deputies to exercise an honorable profession, it is obvious that you will have to raise parliamentary pay to allow them to live decently.[22]

But this very expert pleader of the parliamentary lawyer's cause overlooked the fact that the representation of permanent interests is regarded as legitimate in our society whereas the

[20] "Stavisky needed not a law, but dispensation from existing law." D. W. Brogan, *France under the Republic* (New York 1940), p. 664.

[21] Maurice Leven, "L'avocat parlamentaire," *Revue Politique et Parlamentaire*, 1934, pp. 248 ff.

[22] Remarks of January 18, 1934. Chambre sess. ord. 1934, pp. 169–170. Remarks of Mr. Bowyer in Hansard, vol. CLI (1858), p. 185.

representation of *ad hoc* interests seems to be part of an earlier epoch. On the other hand, we have to remember that party systems like those of the United States, which have rested until now more on tradition and patronage than on the representation of definite economic groups, offer more of an occasion for the advancement of such *ad hoc* interests. This is especially true when the election system does not involve proportional representation.

It is controversial whether the United States statute of June 11th, 1864 forbids a lawyer in Congress to accept pay for acting on behalf of such *ad hoc* interests.[23] The statute forbids the member of Congress to accept payment for representing private interests before any government agency on matters in which the United States is "directly or indirectly interested." While the majority of the Supreme Court has applied this to cases involving general questions of law enforcement, a dissenting opinion of Justice Brewer, in which two other members concurred, challenged this ruling.[24] Brewer argued that the statute prohibited members of Congress from rendering paid services only in cases in which the United States has a pecuniary interest. The interpretation of the majority doubtless expresses our contemporary attitude toward the representation of *ad hoc* interests in return for payment. But the statute itself, as well as the nature of similar legislative attempts during this period, gives some justification to the narrower interpretation of the minority. In practice, at any rate, the minority view has been accepted. Only "the sensitive few" refuse to act in this capacity.[25] But, of course, there is an important difference of emphasis, depending on whether the aim is to obligate a voter, to satisfy the demands of the social and political interests one represents, or to serve as a lawyer in return for special remuneration. When Senator Borah in 1916 very vigorously stated the case against those members of Congress who, as lawyers, accepted retainers from private interests he was quite aware that the majority of lawyers in Congress did not conform to the standards he advocated. He advanced the idea that the lawyer

[23] 35 Stat. 1109, 18 U.S.C. 203.

[24] *Burton v. U. S.* 202 U. S. 344 (1905).

[25] See the instructive correspondence between Mr. Tilsey and Senator Norris, one of the "sensitive few," published by J. M. Landis, *Administrative Process* (New Haven, 1938), p. 101. For more recent material on this question see "PM," September 29, 1940 where the relations between Senator Tydings and the Bata Corporation are scrutinized.

in Congress must have no dealings with business concerns interested in legislative matters.[26] His opinion has, however, found some recognition. In 1931 the Chicago Bar Association adopted an additional canon which terms it improper for a lawyer who is in the legislature to act on behalf of private interests which have a special stake in bills pending before legislative assemblies.[27] Of course the emphasis rests on influencing legislation which, as we have shown, is of minor importance compared with the profit from administrative contacts and all the pressure possibilities inherent in membership in legislative assemblies.

No *generally* accepted rule or standard seems to exist. One point, however, I think, can be made. When the career politician becomes more and more identified with the representation of a specific group interest, he will no longer be at liberty to work for temporary and fluctuating interests. There has developed a certain tendency to consider an individual representative corrupt if he defends for his own private advantage an *ad hoc* case that involves no major social objective. He is as conspicuous as his colleague who is out to profit from government contracts. There are no formal rules to guide his conduct. But the member will doubtless be more cautious in his dealings than he has been for several decades past, since he knows a public disclosure would have an adverse effect on his career. The representation of miscellaneous interests for personal gain is undoubtedly still practised to some extent, but it seems to be more characteristic of an earlier period of parliamentary history.

ADMINISTRATIVE OFFICIALS AND POLITICAL ACTIVITY

The constitutional practice of the eighteenth century, reinforced by the inevitable doctrine of the Separation of Powers, closed the door of the Parliament to officials whose intrusion, it was feared, might make for the domination of the Parliament by the executive. Not all countries followed this example, and when the dualistic structure of the state came to an end with the establishment of the complete dominance of Parliament,

[26] Address before the American Bar Association, Report of the American Bar Association, vol. XLI (1916), pp. 395–407.

[27] *Journal*, American Bar Association, vol. 17, p. 419. See also Peter Odegard and E. A. Helms, *American Politics* (New York, 1938), pp. 763 ff.

the exclusion of officials, though continued in many countries, came to rest on a new basis. The principle of incompatibility between membership in Parliament and the exercise of an administrative office now had the aim of protecting the neutrality of the official more than the independence of Parliament.[28]

It is an open question, however, whether the active participation of administrative officials in the day to day work of legislative assemblies necessarily has a detrimental effect. The election of officials to parliamentary councils might even be desirable in order to prevent the general interest from being subordinated to special interests. Such officials might be in a better position than their colleagues to judge the practical effect of legislation on the public in general and on administrative practice in particular. The work of legislative assemblies would be facilitated, and at least some of the ground now gradually being lost through the delegation of legislative powers to the administration would be regained. But on the other hand, there is something to be said for the arguments of the English Treasury Committee which drew the following conclusions from the sharper alignment of political parties:

> We can feel no doubt, that the confidence universally held in the existence of such impartiality is a most valuable guarantee for its continuance and we can have no assurance that the existent ethic of the Service would long survive such confidence if it were once lost.[29]

What were the advantages, however, which, in the opinion of the Treasury Committee, the people at large would lose if administrative officials were allowed to enter politics? This report used the word "impartiality," which is a somewhat more narrow concept than that of "political neutrality." Impartiality, for instance, requires that an official give the same attention and care to all matters falling within his competence without regard to the person or organization involved. To this extent the impartiality of the official is only an expression for the equality of all citizens in the eyes of the administration, a principle followed by every government which does not acknowledge legal privileges of class or social status. But in the

[28] See W. Weber, "Parlamentarische Unvereinbarkeiten," *op. cit.*, pp. 215 ff.

[29] Report of the Committee on Candidature of Crown Servants, Cmd. 2408, 1925.

case of a government official this impartiality applies only to his official acts. The conception of the "political neutrality" of a government employee, on the other hand, makes no such distinction between an official acting in his official capacity and acting as a private citizen. In fact, the demand for the political neutrality of government employees arises from our knowledge that a distinction between the same individual as private citizen and as official is scarcely attainable; and one reason for restraining the official's political activities is that more complete impartiality may be guaranteed in official dealings.

Before the systematic attempt of the Hatch Act to legislate on this point[30] rules to this effect were laid down for all members of the executive Civil Service in the Civil Service Act of 1883,[31] for members of the Classified Civil Service in some more stringent executive orders, the most important of which dates from June 15th, 1907.[32] The mental climate prevailing during the second half of the last century, in so far as the relationship between executive service and political activity was concerned, may best be judged from the opinion which Chief Justice Waite delivered in *ex parte Curtis*, 1882.[33] A statute of 1876 had ordered instant dismissal of executive officers and all other government employees not appointed by the President with the advice or consent of the Senate, who for political purposes request, give to, or receive from any other officer or employee of the government money, property, or other things of value.[34] Waite's opinion, like all other decisions, upheld the constitutionality of the restrictions on the political activities of public employees. But nevertheless, it read rather like an attorney's opinion given to a political organization advising it that there is nothing in the statute likely to encroach on its assessment of political appointees. Waite upheld the statute on the ground that it had a legitimate object, to promote efficiency by checking any fear on the part of employees that refusal to contribute

[30] If no special reference is given we will speak of the "Hatch Act" although there were in reality two Hatch Acts, the Act of August 2, 1939, entitled "An Act to prevent pernicious political activities" (53 Stat. 1147, 18 U.S.C. 61) and the amendment of July 19, 1940 (Public Law no. 753) "to extend to certain officers and employees in the several states and the District of Columbia the provisions of the Act entitled "an Act to prevent . . . ."

[31] 22 Stat. 403, 5 U.S.C. 633.

[32] See the 24th Annual Report of the Civil Service Commission (Washington, 1907), pp. 7–10, 55–57, 104.

[33] 106 U.S. 371.

[34] The statute in its present form: 19 Stat. 169; 18 U.S.C. 213.

may lead to dismissal. But he took care to point out that there was not the slightest interference intended with a campaign manager not in the federal service who might call on an employee for a contribution. Since Waite acknowledged a political party to be an organization of present or future job holders, no legal device could be expected to separate the community of interests binding the official to the party organization. It did not matter very much, therefore, whether the constitutionality of such a statute was upheld or denied (as in Justice Bradley's dissenting opinion).[35] As long as the liaison of party organization and government officials was a permanent one, necessary in the interests of both, no legislation restricting political activities of government employees was of much avail. And the first reports of the newly established Civil Service Commission show how deep rooted was the custom of obligatory political assessment of executive employees, who were in fact regarded as "members of a class of annual rentpayers."[36]

With the emergence of the Classified Civil Service a much more thoroughgoing set of rules not only could be framed but could also find a willing acceptance among the rank and file of the Classified Civil Service. The extent to which the rules regulating political activity were followed voluntarily may be seen from the figures of the disciplinary procedures which were instigated by the Civil Service Commission:[37]

Members of Classified Civil Service on June 30, 1939	622,832
Total number of proceedings during the fiscal year 1938–39	161 persons
Not sustained	36%
Removed	7%
Suspended and reduced	5%
Asked to discontinue political activities	8%
Cautioned	44%

[35] Bradley's reasoning (106 U. S. 376) by the way, is not without a certain modern touch. Bradley tried to show, in order to prove the seriousness of the infringement on constitutional rights, the all-embracing character of "political questions" that cover liquor, tariff, and slavery alike.

[36] First Annual Report of the Civil Service Commission (Washington, 1884) p. 10; the same report puts forward as a distinct success the fact: "that the practice of former years of organizing in the great cities near the public offices, assessment collection bureaus to which partisan tax gatherers summoned the clerks and laborers of the government and from which they were persued to their desks and workshops, has been wholly discontinued."

[37] 56th Annual Report of the Civil Service Commission (Washington, 1939), pp. 47–8.

THE HATCH ACT AND THE CIVIL SERVICE

Section 9 of the Hatch Act is substantially the same as sect. 1 of Civil Service Rule 1.[38] The Hatch Act makes active participation in political management or in political campaigns incompatible with the holding of public office under the United States. Also, according to section 10 in its revised form, the holding of public office under state and local government is incompatible with political activity whenever the special service involved or branch of the state or its subdivisions is wholly or partially financed by loans or grants from the federal government. While following closely the rules of the Classified Civil Service, Congress took pains to attenuate them in one point. Whereas the Classified Civil Servant was allowed only a "private expression" of his opinion, the word "private" has been deliberately omitted in the Hatch Act.[39] The official is allowed publicly to utter opinions on political matters just as he is allowed to make voluntary campaign contributions and to be a passive member of a political organization, or to take part in a political meeting—except that he may not be a member of organizations which advocate the overthrow of the constitutional form of government (sect. 9 a 1). But the line dividing legitimate from illicit activities runs as follows: He is not allowed to go beyond expressing opinions and enter the field of organizational activities. In this regard the statute falls especially on the public employee who, since he is not under Classified Civil Service, has until now been outside the jurisdiction of the Civil Service Commission. Only in special cases does the statute permit the government employee to engage in political activity. These exemptions are 1) personal exemption in so far as some categories and some specifically named persons are excluded from its application (sect. 9 a). And 2) exemptions for some minor forms of political activity (sect. 16). In localities that have a large civil service element in the population the Civil Service Commission may grant permission to government employees to run for and to accept public office in the locality if such is deemed in their domestic interest.[40] But there is a

[38] See the letter of the President of the Civil Service Commission to Senator Hatch, *Congressional Record*, August 5, 1939, vol. 84, p. 11154.

[39] See the remarks of Senator Hatch, *Congressional Record*, March 4, 1940, vol. 86, p. 4027.

[40] As early as 1873 the simultaneous holding of federal and state or local office was made incompatible by executive orders, later partially covered by 39 Stat. 1106,

difference not only between forming and expressing political opinions on the one hand, and participation in organizational work on the other; there is also a distinction between subscribing to a political party and its main aim, backing a set of political leaders loosely bound to a party platform, and standing for definite social objectives. The message of President Roosevelt accompanying his acceptance of the Hatch Act especially emphasized the right of public employees to answer attacks on their policies and to give factual information relating to the conduct of government affairs; it also emphasizes their right to express their political preferences—provided they do not do so as a part of an organized political campaign.[41] This interpretation recognizes the obvious fact that the official and his work cannot be separated, and that he should therefore be entitled to defend his work and the objectives associated with it.

POLITICAL ACTIVITY OF POLICY-DETERMINING OFFICIALS

But does this right to indicate his political preferences, as the Presidential message phrases it, also imply that the official may take a public stand against the administration, provided that it would be possible to do so without any tie-up with political organizations? Before entering upon this question we should differentiate between various categories of officials for whom the answer need not necessarily be the same. The traditional line of separation between policy-determining and mere executive officials, as it appears in sect. 9 a of the Hatch Act is not very useful for this purpose.[42] A permanent official may have, as administrative practice in European countries has often shown, an immeasurably greater influence on departmental policies than his policy-determining chief. Even many junior

5 U. S. C. 66 (1917). The text of the orders is given as well as the practice of granting exemptions stated in Civil Service Acts and Rules, Statutes, Executive Orders and Regulations amended to June 30th, 1939 (Washington, 1939), pp. 152–154. As regards the admissibility of such exemptions under the Hatch Act, see the opinion of the Attorney General of April 17, 1940. His reasoning, however, that the Hatch Act is directed at political activity rather than the holding of public office is dubious as in most cases political activity and elective public office are inseparably linked.

[41] See *Congressional Record*, August 2, 1939, vol. 84, pp. 10745–47.

[42] On the importance of this difference see the excellent discussion in W. S. Sayre, "Political Neutrality," *Public Management in the New Democracy* (New York, 1940), p. 205. I agree with most of Sayre's conclusions in regard to the desirability of a wide freedom of political activity for the clerical and technical classes of civil servants. The present status of the law, as laid down in the Hatch Act, however, confines their political activity within narrower bonds.

civil servants, if they have energy and vision enough, may play a considerable part in determining the policy of the department. The line must therefore be drawn between officials who perform mere clerical routine duties and those officials who are *de facto* able to coöperate in responsible decisions.[43] Nobody would, for example, think that a public criticism of the administration's policy by a government typist would come under the Hatch Act—provided, first that her criticism did not form part of an organized political campaign and, secondly, that she did not make use of official knowledge known to her only in her capacity as a government worker. So far as she is concerned, the main object of the legislation seems to be to take her out of active party work and to detach her activity from the bonds of political patronage. But the case of a government employee who has a hand in working out the details of the administration's policy belongs in an entirely different category.

As regards objectives on which the policy of the department is not yet fixed, the official cannot go before the public, for if he were to do so, he would in reality be trying to force the hand of his department. As for fixed policies of his department with which he may disagree, the maintenance of public authority does not allow him to take a public stand against such. If broader questions of the government's entire social philosophy are involved, he also has to observe utmost caution, since the public could hardly preserve confidence in an administration whose policy is questioned by the very agent who should formulate it.[44] The situation may seem to be different to a certain extent, in regard to members of independent administrative agencies. Their policy is not in all cases closely connected with the work of the administration and, even though the original impetus for the establishment of the agency may have come from the administration, it now forms an independent institution. But such agencies also in many instances and in many fields follow, or at least should follow, a definite policy. The more recent public dissension in the National Labor Relations Board has shown that the efficacy of such agencies is seriously ham-

[43] As regards the relative uselessness of this approach compare the remarks of C. J. Friedrich, "Public Policy and the Nature of Administrative Responsibility," *Public Policy* (Cambridge, 1940), pp. 5–6, and Pendleton Herring, *The Politics of Democracy* (New York, 1940), p. 382.

[44] See H. Finer, *The British Civil Service* (London, 1937), pp. 202–3. A different viewpoint is expressed by C. J. Friedrich, *op. cit.*, pp. 22–3.

pered when its governing ranks are split into hostile blocs. Therefore, there can be nothing even remotely resembling "dissenting opinions" in the executive's sphere. The dissenting opinions of Justices Holmes and Brandeis in the twenties and of Justices Butler and McReynolds in the thirties pleaded for or reacted against changes in the official attitude towards social problems. They were arguments of minorities, on their way to becoming majorities and of erstwhile majorities that had turned minorities. Dissenting opinions are part of the public-opinion-forming function which the judiciary has in the Anglo-American world. But the sphere of the executive, nowadays more than ever, is a sphere of action; deliberation prevails only in the preparatory stage. The executive officer while bound by duty to reveal to his superior all the doubts with which he is beset on introducing or carrying out a proposed policy of the department, has to carry out the policy loyally, once it is decided on. To allow him to combat in public the executive action or the social philosophy upon which it is based would not only shake public trust in the administration but would even tend to hamper him in the fulfillment of his duty. Acceptance of a government career brings with it, under certain circumstances, the need to make intellectual sacrifices. Where a conflict of loyalties arises, resignation from public office seems imperative as the only solution.

One of the few decisions on the constitutionality of restrictions upon the civil liberties of public employees was delivered by Oliver W. Holmes when on the bench of the Supreme Court of Massachusetts.[45] He took the matter of fact attitude that, after all, everyone who enters a contractual relationship has to renounce certain things he cherishes:

The petitioner may have a constitutional right to talk politics but he has no constitutional right to be a policeman. There are few employments at hire in which the servant does not agree to suspend his constitutional right of free speech as well as of idleness by the implied terms of his contract. The servant cannot complain as he

[45] *John McAuliffe v. Mayor of New Bedford*, 155 Mass. 216 (1891). A later decision *Rotan v. Hasskarl*, 21 Pa. Dist. R. 119 (1912) rests essentially upon the same basis but narrows down Holmes' argument in a legalistic fashion when it states that such legislation does not impose restrictions upon the actions of the individual but is simply a condition of employment. In the more recent case of *Stowe v. Ryan*, 296 Pac. 857 (1931) the Supreme Court of Oregon employs all the arguments brought forward in earlier cases in order to uphold the constitutionality of such restrictions.

takes employment on the terms which are offered to him. On the same condition the city may impose any reasonable condition upon holding office within its control.

Holmes' reasoning somewhat belittled the issue when he placed on the same footing several disparate things. The restriction of civil rights that comes with contracts, the parties to which are in an unequal relationship, has no legal basis. The legal denial, however, to government employees of constitutionally guaranteed civil rights has a well founded justification: the necessity of administrative stability and of administrative neutrality in the face of the groups struggling for their share of political power.

FREEDOM OF ELECTIONS UNDER THE HATCH ACT

The democratic system of government rests on free elections. The protection of this freedom has always been sought through legislation. Free elections not only require an absence of physical constraint and liberty to cast one's ballot as one pleases, but also the absence of those pressures, which, while not preventing the voter from casting his ballot, yet prey on his mind so vigorously and unremittingly that he finds himself totally unable to form anything like an opinion on the issues at stake. The history of the struggle for complete freedom of election is, properly speaking, the history of the progress and the failures of democracy itself. The optimistic belief of enlightened rationalists that a good educational system would enable the voter to review the issues with objectivity has not been justified. But this optimism was an important factor in the frequent attempts to introduce a measure of "equality of opportunity" for all competitors in electoral contests and to safeguard against the pressure of moneyed interests. While the legislators were still engaged in their uphill fight to introduce a certain amount of equality of opportunity into the preparatory stages of a campaign, a new danger was already looming on the political horizon. The tide of state interventionism and the extension of social services in particular made the administration an important factor in election contests, so much so that its attitude could affect the ultimate outcome of the election. The voter's freedom thus became a precarious one, hanging in a delicate balance, with its survival dependent upon the permanence and

width of the rift between the administration and the most powerful economic groups.

It is against this background that we have to consider the Hatch Act. The Act may have been the outcome of certain clever legislative manoeuvres, but it also represents an attempt on the part of some bewildered political craftsman to cope with those dangers we have described and to give the voter a chance. The attempt to do this takes two forms. First, the Hatch Act continues in the accepted tradition by making a bid for a greater amount of equality in the electoral process. It tightens the provisions against excessive campaign contributions by setting definite limits to individual gifts as well as to the total sum to be spent by a party committee (sects. 13 and 21); it closes some of the more manifest loopholes left by earlier legislation (sect. 13 a); and it forbids individuals or firms which are negotiating contracts or which have contracts with the United States to make any kind of political contribution (sect. 20). The severe restrictions of the Act on the total outlay of campaign expenditures undoubtedly have produced changes in the forms and ways in which campaigns are financed. Increasing resort has been made, in the 1940 elections, to independent citizens' committees without any visible political affiliations which, in the fullness of civic spirit, bought a lot of advertising space. It is doubtful, therefore, whether the attempt of this legislation to introduce definite limits upon campaign expenditures will prove successful and whether it will be able to prevent the most powerful groups from stealing the show, at least so far as propaganda is concerned. The triple influence exerted by those who can afford to pay, 1) on the formulation of the party platform and the selection of the candidates; 2) on those voters who can be impressed by propaganda; and 3) on those who can be induced by their status of dependency to vote for the "right" candidate, will in all probability continue unabated.

The element, however, which has proved much more effective than any Corrupt Practices Act as an antidote against private economic pressure is the emergence of the administration as an independent political power. A good part of the Hatch Act is occupied with this problem of the administration as a new force competing for the voter's favor. It tries to give guarantees against administrative interference in election matters. Its section 2 which comes out against "the use of official authority

for the purpose of interfering with elections" at first seems only to repeat the time honoured prescription of early legislation. However, when taken in connection with sections 4–8, the provision takes on a more concrete meaning. Every kind of authority, official and private alike, can easily be used to sway those who depend for their very existence on this authority. And just as continued unemployment makes the worker who is still steadily employed more likely to give weight to the proposals of his master, so the unemployed will be inclined to give special attention to the representatives of the public relief agencies. The Act, therefore, contains an all-embracing provision against those who try to exert political pressure by threats against relief recipients (sects. 4 and 7). Likewise the relief recipient receives the negative privilege of not being permitted to contribute to political campaigns (sects. 5 and 6). The message of the President and the Congressional debates make it clear beyond any doubt that the provisions were enacted to meet the special situation of the unemployed—to counteract their absolute dependence on the discretion of administrative officials.[46] These sections therefore do not apply to the remaining army of those receiving federal money. Part of this army, though in need of federal aid and dependent upon decisions made more or less at the discretion of administrative agencies (HOLC, RFC, and AAA, for instance), is not bare of resources. They therefore do not appear to be susceptible to administrative pressure in any appreciable degree. This is shown by the fact that no complaints, such as those directed against the administration of the WPA, have been brought against these agencies. Another group of recipients, the veterans, those receiving old age and security grants, and those receiving retirement pensions, derive their benefits directly from statutory provisions which allow no appreciable measure of administrative discretion. But even so far as straight relief recipients are concerned, the remedial effect of the legislation, when measured by election results, seems restricted. What is likely to dwell most heavily on the voter's mind is the beneficial consequence of the social services provided and not the individual manipulation of them by the officials. Just as the remedial legislation in the different Corrupt Practices Acts has been unable to

[46] See the discussion in the House of Representatives on July 20, 1939, *Congressional Record*, vol. 84, pp. 9596 ff.

remove the influence of private economic dependency on voters, so no legislation against administrative pressure on voters will be able to upset to any considerable degree the impact of advanced social legislation on the minds of the voters concerned.

PATRONAGE AND THE POLITICAL MACHINE

But what about the effect of the Hatch Act on the fate of political machines? A number of federal officials will still be appointed through Washington and will not belong to the Classified Civil Service. Yet the rather narrow channels in which the Hatch Act confines their political activities makes them unfit for the task of building up a political organization. The consequent disinterestedness of the central administration in these offices may therefore have a certain decentralizing effect, leaving the local patronage exclusively to the regional members of Congress.[47] Any judgment on the effect of withdrawing the WPA from the sphere of party politics will depend on which of the following interpretations is correct—whether the WPA's role was among other things to serve as the old fashioned vote-getting device or, as my own interpretation would suggest, whether the WPA was rather a response to the social needs with profound repercussions in patterns of life and hence outside the sphere which can be touched by the Hatch Act. The extension of the Hatch Act to local and state employees whose activity is financed with federal funds has eliminated the potential danger that the destruction of the federal patronage machine would result only in a transfer of machine politics from the federal to the state units.[48] The effect of this amendment on the political machines of the states is far-reaching and thorough-going, as these state machines are very vulnerable because of their dependence exclusively upon patronage. We should like to quote here the remarks of Senator Chandler of Kentucky:

> There will not be any effective state machinery in my state if this bill is passed. It will take the Highway department, the Old-Age Pension department, the Unemployed Compensation department and there will be virtually nothing left.[49]

[47] Herring, *op. cit.*, pp. 223–24.
[48] On the "transfer problems" see the remarks of Senator Johnson of Colorado on March 12, 1940, *Congressional Record*, vol. 86, p. 4197.
[49] *Congressional Record*, March 12, 1940, vol. 86, p. 4199.

But will not the city machine, which does not depend on federal grants to such an extent as the state administration, be a likely heir to the federal and state patronage? A certain danger does exist in this respect, but its extent is not to be overestimated; the healthy competition we find between the two major parties in cleaning up each other's corrupt cities during the last few years should set definite limits to such a substitution of local for state machines.

The jurisdiction of the Civil Service Commission is widened as a result of the uniform restriction laid on political activities of almost all government employees. This foreshadows the permanent inclusion of the whole army of government employees in the ranks of the Classified Civil Service in the near future. Students of civil service problems, while recommending such an extension of the Classified Civil Service to all but a handful of government employees, have expressed their belief that the career service system "would place politics as a whole on the higher plane of issues and men, not of jobs and special privileges."[50] It is undoubtedly true that the disappearance of the administrative jobholder as one of the basic elements of political parties will bring issues of a wider nature to the fore in party councils; but it remains an open question to what extent such a development will be a factor in stabilizing the political life of a democracy. The worst quality of jobholder parties, when considered from the viewpoint of the purity of political doctrine—the inconsistency of their programs, the adaptation of their policy to changing situations, and their unlimited proclivity for shifting toward points of minor resistance—is not altogether a fault so long as compromise remains the ultimate virtue of democratic government. It is a distinct possibility, if not an inevitability, that the vanishing preponderance of the jobholder element will make for bitter clashes and for a decreasing readiness to compromise. It is difficult, with so many influences at work on the transformation of the party system, to disentangle the impact of this surgical operation which cuts the administrative official from party politics. But it seems safe to predict that, when rigidly enforced, the statute may accelerate this process of party transformation. And granted the

[50] "Report of the Commission of Inquiry on Public Service Personnel," *Better Government Personnel* (New York, 1935), p. 81, and L. D. White and T. V. Smith, *Politics and Public Service* (New York, 1939), pp. 151 ff. See also the critical remarks of Herring, *op. cit.*, p. 385.

premise that such a structural change of the party system is well under way anyhow, its possible acceleration may be acceptable too, provided that it goes hand in hand with an increase of efficiency in the administrative services.

STANDARDS FOR OFFICIAL CONDUCT

Some time ago, in a Central American country, the proposal was made that every executive officer's bank account as well as the accounts of the members of his family should be made accessible to public scrutiny from the moment he took office until he left it. A similar proposal, only of a somewhat more restricted nature, was brought forward in this country during the 1940 presidential campaign.[51] The fact that such proposals are in the air is as characteristic as the fact that they never make much headway. Administrative action in our day has much greater influence in the welfare of every member of the community than in earlier days, but the increased weight of administrative action has not been matched by a corresponding increase in control mechanisms. The very haphazard quality of legislative control as well as the diminishing influence of legislatures in general, has coöperated to weaken the efficacy of their hold over an everexpanding administration. In our search for other devices to assure administrative responsibility, there appear controls which are indefinite in scope and extent, such as the proposal to check on bank accounts. In exchange for the increasing power we must bestow on the official, we would like to see him made more strictly accountable for all aspects of his activities, private and public alike. For the old post offices where we could only get a furtive glimpse of the clerk through a narrow window, we have substituted new structures where we can observe every detail of the employee's activity. Should we be able to extend the same degree of scrutiny to an official's whole life, as proposals ask us to do? Apart from the usual technical difficulties which might be overcome, this scrutiny would involve much more than watching suspicious financial operations as evidence for any kind of malfeasance in office. As the discussion of the financial affairs of official personalities and their families shows, the examination of bank accounts would lead to the setting of more or less

[51] *New York Times*, August 8, 1940.

arbitrary standards of morality. It would introduce the vestiges of an egalitarian censorship in a community the social system of which, up to this moment, rests rather on the opposite principles. Besides that, the extension of this censorship to the families of officials would quite indiscriminately subject the many non-official members of an official's family to the special standards set for the official. It is therefore extremely unlikely that any such proposal involving the public acknowledgement of two different sets of moral standards, that for the official and his dependents and that for the "private sector" has any chance of realization.[52] Social revolution rarely comes through a back-door, or, as Rousseau puts it: "*La censure peut être utile pour conserver les moeurs, jamais pour les rétablir.*"[53]

But the task remains: If the administration is to do its work efficiently it must take care that its members do not yield to private interests which desire to influence their decisions. Of course, the most powerful guarantee against undesirable developments within their ranks consists in the esprit de corps of their members. No supervision from above can be as effective as an automatic control on the minds of those possessing it and creating standards of efficiency as well as honesty. Any deviation from the common standards under such circumstances is likely to be discovered sooner or later and rooted out.

THE BORDERLAND OF PRIVATE INTEREST

But more important than the problem of deviation from acknowledged standards of behavior are those groups of cases where it is difficult to establish sharp lines of demarcation between permissible and culpable conduct. Many of these questions arise from the contacts between the business community and the official world. These contacts may unfavorably influence the official's activity in a twofold respect. Present or future interests in business may sway the administrative decision of an official, or the government functionary may use his official knowledge inaccessible to others, for his or his associates' private advantage. The simplest precaution against the possibility of private interests standing in the way of the

[52] As regards the factual difference between the moral standards of officials and business men, see M. J. Dimock, "Do Business Men Want Good Government?," *National Municipal Review*, January, 1931 and J. Baker, "The rank and file," *Public Management*. . . . p. 184.

[53] *Contrat Social*, IV, 7.

dutiful performance of public functions has always been to declare the two legally incompatible. Thus, for instance, an Internal Revenue officer or agent would be dismissed and fined if he were found to be directly or indirectly interested in the manufacture of tobacco or in the production of spirits.[54] And persons employed in Indian affairs would likewise be dismissed were they to have any concern or interest in Indian trade.[55] But not all incompatibilities are so easy to establish and the technique used has not always been successful in achieving its aim. For instance, a statute of 1789[56] forbade the Secretary of the Treasury to be directly or indirectly interested in "carrying on the business of trade or commerce," and it could be argued in 1929 by Attorney General Mitchell on the authority of the Supreme Court's narrow construction of similar phrases in the Hepburn Act, that the holding of considerable stock in a corporation did not constitute "carrying on the business" of the corporation.[57] While this opinion seems rather weak from a legal point of view, the sociological lines of his reasoning are more pertinent. He explains that with the alternative construction of the statute a great majority of the competent men may be prohibited from holding office. As regards the matter of confidence, opinions may differ, but we agree that strict incompatibility rules for cabinet members seem unwarranted. The President should have full freedom to choose for his close associates the very exponents of those interests which his interpretation of the national welfare leads him to think are the most vital ones.[58]

The statutes placing vast powers of administrative adjudication in the hands of independent commissioners were more careful and thoroughgoing in the restrictions they imposed on the private activities of these persons. From the very beginning two points were emphasized when such commissions were

[54] 19 Stat. 248, 26 U. S. C. 1828 b (1877).

[55] R. S. § 2078, 25 U. S. C. 68 (1834) widened by 18 Stat. 177, 25 U. S. C. 87 (1874), (exemptions: 53 Stat. 1840, U. S. C. 68a, 87a, 1939), a broad construction prevails: *U. S. v. Douglas*, 190 F. 482, (1911) and Op. Atty. Gen. of February 15, 1940.

[56] R. S. § 243, 5 U. S. C. 243.

[57] 36 Op. Atty. Gen. 12 (Mellon case) 1929, based on the authority of *U. S. v. Delaware and Hudson*, 213 U. S. 366 (1908). See also Justice Harlan's dissenting opinion, *ibid*, p. 419.

[58] Similar narrow interpretations of the phrase "carrying on the business of trade or commerce," upholding the admissibility of commercial activities of judges (with some reservations, however) *in re Deuell*, 127 N. Y. App. Div 640 (1908), *in re Levy*, 198 N. Y. App. Div. 320 (1921).

created. The commissioners were forbidden to follow any other vocation, trade, or employment; and they were not allowed to have any kind of part or interest in businesses falling under their jurisdiction. These rules were inscribed in the statute establishing the Interstate Commerce Commission.[59] They were consistently adhered to when new commissions were created.[60] With the drafting of the rules governing the conduct of the members of the Federal Communications Commission the most complete formulation of such policy was achieved. An effort was clearly made throughout to free the commissioners as completely as possible from any considerations of private interest which might affect their official judgment.[61]

The possibility that officials will be able to make profits through special information that is accessible only to insiders increases in times when government decisions have a growing impact on all kinds of business transactions. This danger hastened the tendency to subject the business transactions of officials to stricter control. Official disapproval has considerably sharpened since the time when Herr von Holstein, the *eminence grise* of the German Foreign Office could use his official information for his private speculation without interference.[62] When Mr. Gregory and his associates from the British Foreign Office did the same in the years after the World War, they were dismissed and the ruling was made that officials are forbidden any kind

[59] 24 Stat. 383, 49 U. S. C. 11 (1887).

[60] Federal Reserve Board: 38 Stat. 260, 12 U. S. C. 244 (1913). Federal Farm Loan Board: 39 Stat. 360, 12 U. S. C. 654 (1916). Federal Farm Board: 46 Stat. 11, 12 U. S. C. 1141 a (1929). Federal Power Commission: 46 Stat. 797, 16 U. S. C. 792 (1930).

[61] 48 Stat. 166, 47 U. S. C. 154b (1934). This statute builds up an interesting net-work of defense mechanisms in order to guarantee the complete independence of the members from outside influences. The rules forbid the Commissioner 1) to be financially interested in the manufacture or sale of radios and any conceivable kind of related products, or to be interested in companies owning stocks in the above mentioned enterprises, 2) to be in the employ of or have any official relation with any person whose activities come under the provisions of the act, 3) to own stock in any corporation which comes under the Commission's jurisdiction. The provisions of the Securities and Exchange Act fall short of this standard. Besides the usual prescription forbidding the Commissioner to engage in any other business the statute only interdicts the Commissioner to participate directly or indirectly in stock market transactions which are subject to the regulatory activity of the Commission. 48 Stat. 885, 15 U. S. C. 78d (1934).

[62] As regards the widespread nineteenth century practice of using official information for private speculative purposes, see H. Rogge's Introduction to Friedrich von Holstein's *Lebensbekenntnis in Briefen an eine Frau* (Berlin, 1932), pp. xxix–xx. See also the significant correspondence between Holstein and Bismarck, *ibid*, pp. 116–17 where Bismarck allows his subordinate active participation in a Belgian business firm although continuing his service in the German Foreign Office.

of speculative stock market transactions.[63] When Mr. Thomas, Minister in Labor and Conservative governments, commercialized his advance information on the forthcoming budget, he had to tender his resignation as Minister and as Member of Parliament as well.[64] Using official knowledge for personal gain while holding public office is today held to be contrary to the ethical code of officialdom, although it is not punishable through criminal procedure where special statutes make no such provision.[65] This ethical code is equally violated when the official uses his position to bring pressure on a private or semi-private corporation which is largely dependent on his good will in order to acquire a profitable post therein. The rule forbidding the combining of public business with the advancement of personal private interests was established in the case of Sir Christopher Bullock, the Permanent Secretary who tried to get himself the position of Chairman, or at least Director, of Imperial Airways by such means.[66]

PUBLIC OFFICIALS AND PRIVATE EMPLOYMENT

But let us suppose, for a moment, that the directorate and the Chairman of Imperial Airways had shown more sympathy for Sir Christopher's aspirations and had offered him the coveted position. In this case the appointment would have been regarded as perfectly normal according to prevailing opinion. In spite of many attempts, no satisfactory solution has yet been found for the problem of how far restrictions should be imposed upon officials who wish to resign their offices for private positions or upon those accepting private positions while on retirement pay. But the appointment of civil servants to private positions may be objectionable for two reasons: 1) The prospective appointee, to improve his chances for a lucrative private post, may allow himself to be disproportionately influenced by representatives of those private interests with whom he has to deal in his official capacity. Offering honors, as Sir Christopher

[63] Report of the Board of Inquiry appointed to investigate certain statements affecting Civil Servants. Cmd. 3037 (1928).

[64] Budget Disclosure's Inquiry Cmd. 5184 (1936).

[65] *U. S. v. Haas* D. C. N. Y. 167 F. 211 (1906). Special statutes: 35 Stat. 1110, 18 U. S. C. 214 (1909), advance information of crop reports, 44 Stat. 117, 18 U. S. C. 216 (1926), disclosure of operations of manufacturers and income tax returns.

[66] Report of the Board of Inquiry appointed to investigate certain discussions engaged in by the Permanent Secretary to the Air Ministry, Cmd. 5254 (1936). See also Finer, *op. cit.*, pp. 174–79.

did, would be relatively harmless, but cases may arise of his offering them more substantial advantages at public expense. 2) The private interests may be willing to take him on their payroll for a higher remuneration than the government offers, simply because they expect special future advantages to accrue from their appointment of him. The advantage may consist in the use of his special technical training and skill, in which case no special damage would arise unless the government is in competition with this business, or national defense interests are concerned. In many cases, however, it is not special technical ability which a private employer tries to secure for himself. He rather looks for knowledge of administrative procedures, which may or may not be of a confidential character in the particular case, and for the advantages which accrue to him through having on his staff a man with administrative connections. These points have received attention during the inquiries into the armament industries in Great Britain as well as in this country.[67]

In the course of the English inquiries, the commission formulated proposals to the effect that officers, whether active or retired, should not enter the service of armament firms in any capacity without the specific approval of the Minister in charge of their department.[68] The Baldwin government, however, in its criticism of the proposals, was not prepared to go so far. It raised a number of technical points, such as the problem of defining an armament firm. Finally, it took refuge behind the observation that the question is not restricted to the armament business and calls for careful study.[69] Under the pressure of public opinion, however, a set of rules was published a short time later. They began with a kind of apology, emphasizing that there is nothing improper in principle in the acceptance of business appointments. They went on to decree that for a specific number of occupations and for specific categories of

[67] Minutes of evidence of the Royal Commission on the private manufacture of and trading in arms (London, 1935 and 1936). See especially the "statement of evidence submitted by the Union of Democratic Control, Part 6, Government Servants and the Arms Industry," pp. 198–200, pp. 681–84. As regards this country see the hearing of December 11, 1934, before the special Senate Committee investigating the munitions industry. U. S. Senate Special Commission Hearings, 73rd Congress, vol. 12, pp. 2644–2706.

[68] Report of the Royal Commission on the private manufacture of and trading in arms, Cmd. 5292, 1936, p. 109.

[69] Statement relating to report of the Royal Commission on the private manufacture of and trading in arms, Cmd. 5451 (1937).

officials, those seeking private employment within two years of resignation or retirement from public office would have to obtain the prior consent of their particular Minister acting after consultation with the Treasury.[70]

The two years' limitation may also be found in some legislative enactments of this country. A statute of 1872 forbids any person, appointed as officer, clerk, or employee in a government department, to act, until two years after he has left office, as counsel, attorney, or agent for prosecuting any claim against the United States which was pending in the department during his stay in office.[71] This statute does not in general hinder the employment of former government officials by private employers. Neither does the supplementary statute of 1919. Employees and civil and military officers of any procurement division of a military establishment may not solicit any orders from such military establishment or help to prosecute claims against it for two years after they have left the service.[72] As this statute levies a penalty for any violation, it has contributed to prohibiting former army officers who were later employed in the armament industry from acting in the formulation or procurement of army contracts. The general statute of 1872,[73] however, did not levy any penalty (enforcible by penal agencies) upon those former government officials who act as counsel in cases for their new private employers against the government. Its application remains confined to those cases where a not too scrupulous business man takes refuge behind the statute to fight off the claim of a former government employee who helped him win a case against the government.[74] When the courts show reluctance to side with such business men the statute may be further emasculated by a narrow technical interpretation of the phrase "pending claim."[75]

This state of affairs does not seem very satisfactory, par-

[70] Memorandum on the subject of the acceptance of business appointments by Officers of the Crown Services, Cmd. 5517 (1937).

[71] 17 Stat. 202, 5 U. S. C. 99.

[72] 41 Stat. 131, 5 U. S. C. 100 (1919). This statute was made necessary by a ruling of the Attorney General excluding the application of the statute of 1872 to army officers not working in the War Department, 31 Op. Atty. Gen. 471 (1919).

[73] The supplementary *Treasury* rules, 23 Stat. 258, 5 U. S. C. 261 (1884).

[74] *J. T. van Metre v. G. C. Nunn*, 116 Minn. 444 (1912) where a broad construction of the term "pending claim" prevails and a former Indian officer was prohibited from collecting a fee from his client whom he had assisted to establish a claim against a government agency without trial. See also *Ludwig v. Raydure*, 25 Ohio App. 293, certiorari denied, 275 U. S. 545 (1927).

[75] *Day v. Laguna Land and Water Co.*, 115 Cal. App. 221 (1931).

ticularly since the emphasis of this legislation rests entirely on preventing former officers from representing their new employer's claims against the government. This emphasis leaves out the widest segment of the problem. Even when those involved are only minor internal revenue officials who left the government employ to take jobs with corporations whose tax returns they had investigated, the statute and the supplementary Treasury rules offer only partial and haphazard remedies. The cases of former army officers who were later put in the pay of armament firms have received much adverse publicity. On this account and as a result of the statutory restrictions put on them, they do not appear to be a material problem today. There does prevail, however, the continuing practice wherein government officials take private jobs. No rule exists in this country prohibiting officials from changing their allegiance in this way. Until now, such acts have been regarded as perfectly normal—in fact, as a kind of promotion which, if it does not draw more distinction with it, at least brings the advantage of a higher salary. But some distinctions and observations seem imperative. If a trial examiner of the N L R B quits its service to become an independent labor lawyer, he takes with him the knowledge of how to handle labor cases together with a certain acquaintance with the personnel and the procedures of this agency. The same may be said for a Securities and Exchange Commissioner who establishes himself in the securities business. In both types of administrative agencies the official business is promoted by public hearings and the rules established by the agencies are not only given full publicity but are also subject to judicial review. The same cannot be said in the case of the chief of a procurement division of an administrative department who enters private business—both conditions, publicity and judicial review, being absent here. Of course, the individual situation among the mass of civil servants varies considerably, and it would be difficult, if not impossible, to sketch *a priori* rules and to subject certain classes of civil servants to close restriction while leaving others altogether free to enter private employment when they choose to do so. For this very reason, the inadequate rules that now exist, aiming only at former civil servants who attempt to represent private interests before government boards or agencies, should be revised. A central agency should decide in every individual

case whether and under what conditions a government employee is to be allowed to seek private employment. This agency could best be established as part of the Civil Service Commission, thereby avoiding the personal considerations that might otherwise come to the fore. To be sure, this agency would only decide after it had heard the official department concerned, as well as the civil servant and his prospective new employer. The emphasis would not lie so much on forbidding the change over to private service (a step which would be taken only if necessary) but on keeping close watch at all times on which departments and what kinds of activity constitute danger zones that might prove prejudicial to the proper conduct of public affairs. Whether the British two-year limit should be maintained or the period extended seems at least debatable but less important than having a central authority with jurisdiction over all government employees.

THE CHANGING RÔLE OF THE PUBLIC SERVANT

Instituting such checks and controls on the private business activities of civil servants merely constitutes public acknowledgement of the official's changed status. A world separates the civil servant of today, especially the more highly qualified one, from his ancestor of sixty years ago. In that earlier time, a man often entered government employ because he had not enough vitality and energy to establish himself in business. Today the member of the higher ranks of the civil service will often be the equal of the business man, if not superior to him, in power and social standing, even if the material resources he commands are his only in his official and not in his private capacity.[76] If he does not of himself command the tools with which he can change social and political institutions, the very fact that he is entrusted with the task of keeping the complicated machinery of government running places him in a strategic position. We are now becoming frightened by the power which we are more

[76] As the dollar-a-year man lacks the essential characteristic of an official, permanence of tenure, his problems are not treated here *in extenso*. A tendency seems discernible, at least among the top ranking dollar-a-year men, to sever their business connections, as Mr. Baruch did during the last war. An immediate conflict between the private interests of the dollar-a-year man and his official duties would thus be prevented. The question remains, however, whether the participation of representatives of powerful industrial groups in administrative decisions is of a beneficial effect for the nation as a whole. Opinions differ widely on this point. For recent material on this point see *P. M.* of Nov. 24, 25 and 26, 1940.

or less forced to bestow upon him, and we are uncertain whether he is our servant or our master. We try to protect him as well as ourselves from the temptations inherent in that power. We attempt to neutralize him politically, knowing well, however, that his neutrality can never be absolute and may only be very provisional.

We have before our eyes today the model of the Fascist state where the boundaries between private advantage and public benefit, between the pursuit of private interest and the tenure of public office have become indistinct. As the power of the official increases, it is all the more imperative in democratic countries to draw a clear distinction between the tenure of public office and the pursuit of private interest,—if the official is to remain the executor of national policy and the trusted mediator between conflicting interests of independent groups. We do not want him bound to special interests, not only because he may become forgetful of his duties in a particular case but because we do not wish his methods of thinking and his social attitudes to be tainted by any association with a special group. Our society in transition cannot offer him a ready-made system of values to which he ought to subscribe. But we are anxious to see him set himself new standards of behavior through his position and prominence within the community rather than to see him follow the somewhat dubious patterns of the past. As we become more conscious of his part in the determination of the national destiny, the narrowing limits within which he may carry on his private business activity—expressed in terms of stricter incompatibility rules—become the more discernible.

CONTROLLING BROADCASTING IN WARTIME

A Tentative Public Policy

Carl Joachim Friedrich

SUMMARY

How *to handle the control of radiobroadcasting in wartime is the most vexing problem in the field of communications, due to the novelty of this channel. To argue that broadcasting might be handled like the press is to neglect that novelty.*

A further difficulty arises from the lack of knowledge we possess regarding the control of broadcasting. We are dealing with a complex pattern, in which control is shared by the broadcasters, the advertisers, the regulatory agencies, and the general listening public.

In planning for broadcasting during a war fought outside the Americas, four main considerations must be kept in mind: military needs, morale, defense against espionage and sabotage, and the problem of maintaining good will abroad, especially in Latin America. According to the Federal Communications Act of 1934, the President is empowered in a national emergency to act as he sees fit in dealing with radiobroadcasting.

Mature consideration would seem to indicate that outright military control of broadcasting would be unwise. The needs of the armed forces can be met without their shouldering the task of running the broadcasting industry. Morale can be better maintained by keeping the broadcasting structure intact as nearly as possible. Moreover, military authorities seem to feel that neither the army nor the navy has adequate personnel for this task.

A more adequate solution seems to lie in an adaptation of the existing system. In order to counteract possible dangers of espionage, it is suggested that listening centers be set up in strategic points throughout the country to monitor broadcasts. To deal with possible dangers of Fifth Column activity, stations should be adequately guarded. Because of the nature of modern warfare, the maintenance of morale is a feature of inestimable importance. To aid in this task, it is suggested that a radio program board be set up with power to initiate some programs, to direct the channeling of other programs, and to see to it that the government's point of view is adequately presented. This central program board would be staffed by specialists in radio and be in constant touch with any organization within the government concerned with policy formation. It

should undertake listener research in order to be sure that its aims were being realized. One of its most important problems would be that of encouraging local stations to assist in the work. However, in the event of a crisis, some arrangement should be made whereby the government could obtain nationwide coverage instantly.

THE EDITORS

It is fully realized that this study on the control of radiobroadcasting in wartime is concerned with highly controversial matters. There is no precedent to build upon. Conclusions, such as they are, should be considered tentative; they are working hypotheses at best.

Practitioners of the art of broadcasting often question the necessity of such an undertaking. "Why should we plan for radio in wartime, if we don't do it for the press?" they ask. A justifiable pride in their achievement makes them a bit touchy about being thus subjected to a solicitude they have not invited. The answer to this question is rather elaborate. There is no precedent for the control of radio in wartime, and radiobroadcasting presents technical complications which are not present in the case of the press.

It is often forgotten that the press has been handled in many previous wars. Each succeeding generation has had to handle novel and, in some ways, unique problems, but in spite of all this experience has been accumulating as to how the press has to be managed in wartime. The radiobroadcasting business on the other hand has been almost entirely developed since the World War and hence the questions connected with how to organize control during wartime are wholly new. What is worse, the pattern of control of radiobroadcasting in the United States is not any too well known nor understood at the present time so that we are groping in the dark. There are other pertinent contrasts between the media.

Newspapers form a permanent record. The printed word is in itself evidence, and we can easily check whether a newspaper or magazine has been carrying subversive material and punish the responsible individual. Radio leaves a record only in the minds of the listeners. In the event of an emergency, broadcasting presents immediate opportunities and dangers. Unlike the newspaper, its facilities are to some extent at least available to the enemy. Many technical tasks are confronting us. It is

not generally realized that in spite of extraordinary developments in radiobroadcasting in the United States, national coverage is not as yet available. To get it we may require superpower, reallocation of stations, extension of networks and changed equipment. All these changes need time and should be ready in the event of hostilities. No such demand for newspaper equipment is to be expected. Further, the possibility of guiding enemy bombers by radio beams cannot be overlooked. Several alternatives have been suggested for avoiding this danger of directional flying. Whatever is done, careful plans should be made in advance.[1] Due to the possibility of widespread and instantaneous pick-up, the chances of a scare are much greater in radio than in the press. The famous incident of "The Invasion from Mars" is a case in point.[2]

There has been continuous controversy over control of radiobroadcasting in the United States.[3] The difficulties are sufficient to give any detached careful observer great concern. It may be doubted that so intricate a problem can be settled successfully once the emergency is confronting us. Even today, several government departments, Congress, and the industry are contending over various plans for control of radio in wartime. Under such conditions effective analysis of all available knowledge is highly desirable. Such knowledge if collected and distributed by a neutral source is more apt to carry conviction for the conclusions arising therefrom than the same knowledge presented by one of the parties at interest. From all this it seems to be very clear that radiobroadcasting control should be fully explored as soon as possible.[4]

Broadcasting has become one of the main channels of communication in recent years. In certain respects it has, in the United States, probably surpassed all others in importance.

[1] Further reasons why radio needs more careful control than the press may be found in Paul F. Lazarsfeld, *Radio and the Printed Page* (New York: Duell, Sloan and Pearce, 1940).

[2] The effect of this broadcast has been analyzed by Hadley Cantril with the assistance of Hazel Gaudet and Herta Herzog in *The Invasion From Mars* (Princeton: Princeton University Press, 1940).

[3] There is a good treatment of the difficulties in regulating radio before 1932 in Laurence F. Schmeckebier, *The Federal Radio Commission* (Washington: The Brookings Institution, 1932).

[4] A number of men of great practical experience have generously contributed of their time and knowledge to this study but none of them is to be held responsible for the views presented here. The following have been consulted: Mr. Charles A. Siepmann, Mr. Edward Klauber, Mr. Paul Kesten, Mr. George T. Van der Hoef,

Communications are generally important for those seeking to control the community. They are particularly vital in a democracy. Hence the control of broadcasting facilities has become a significant problem. Like other problems of control, the problems of the control of broadcasting arise partly from the control pattern prevailing in the community, partly from the technical nature of the activity to be controlled. In the latter respect there has been an almost continuous evolution in the years since broadcasting was first invented, hence no stable, balanced conditions can be described which would provide an adequate basis for generalization. We must be content if we succeed in adequately comprehending and describing the shifting scene of control. In fact, so rapid has been the rate of change that a sketch of the problems of control is essentially a sketch of the *history* of the organization of the radiobroadcasting industry and its self-regulatory as well as governmental control devices.[5] To illustrate by the facts before our eyes, as these lines are being written, the emergence of frequency modulation as a technique for broadcasting on ultra-high frequencies brings forward the prospect of a new revolution in the technical nature of the medium as we have known it. Technology keeps changing the substance of broadcasting.

It is obvious that a general pattern of political control such as prevails in Britain, let alone in a dictatorship, would imply a different system of controlling radiobroadcasting. But even in the United States, the word democracy may obscure a more complex pattern of shifting control in the community. Everyone knows that the middle twenties, when utility magnates passed freely into the President's office and the head of the aluminum combine was Secretary of the Treasury, implied

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Mr. Wendell S. Gibbs, Mr. Roscoe Wright, Mr. Morse Salisbury, Mr. Winston B. Stephens, and Mr. Daniel H. Schwartz. Others, equally helpful, desired not to be named.

This paper is part of a study which was aided by a grant-in-aid from the Rockefeller Foundation which made Miss Jeanette Sayre available as research assistant. This assistance is gratefully acknowledged.

[5] There is a history of radio in the United States in spite of the aversion of most historians to deal with recent materials. Cf. Gleason L. Archer, *History of Radio to 1926* (New York: The American Historical Society, Inc., 1938) and *Big Business and Radio* (New York: The American Historical Company, Inc., 1939). Further treatment of these problems may be found in *Broadcasting and the Public* by the Department of Research and Education of the Federal Council of Churches of Christ in America (New York: The Abingdon Press, 1938), and C. B. Rose, Jr. *National Policy for Radio Broadcasting* (New York: Harper and Brothers, 1940).

a pattern of business ascendancy very different from the New Deal era of the middle thirties, with its governmental yardsticks for private enterprise. Regardless of how one may look upon this contrast, there can be little doubt that a new and unexplored channel of communication will be controlled by those who are controlling the community. That radiobroadcasting emerged in the middle twenties has to date stamped the peculiar pattern of control upon it which has become known as "The American System of Radiobroadcasting."

Since radio is an ubiquitous channel of communication and hence a major factor in persuasion,[6] those wielding power in a given community cannot readily neglect participation in its control. It might in some instances be easier to show who thus participated in the control of radiobroadcasting, and to argue from such an analysis that the evolving control of radiobroadcasting during the last twenty years reveals the shifting incidence of power in our land. Certainly the striking contrast between Great Britain and this country, both described as democracies in a general sense, reveals an underlying difference in the control groups. The British Broadcasting Corporation has, throughout its existence, been primarily controlled by the so-called "governing class" that is to say the conservative and aristocratic elite which dominates Oxford and Cambridge as well. Parliament, to be sure, has had a supervisory control which was formally limitless, but in reality quite restricted.[7]

Hence it might be claimed that the evolving control of radiobroadcasting during the last twenty years reveals the general pattern of control in the particular community. The outcome of the struggle for its domination mirrors the general distribution of power in the community.

This contention fits in with the picture in the United States as generally known. "Government" in the formal sense was not in a position to appropriate control of radiobroadcasting, except in those fields admittedly committed to its charge, such

[6] Persuasion is one of the three basic sources of power, the other two being physical force and wealth. See my *Constitutional Government and Politics* (New York: Harper and Brothers, 1937), Chap. I. The same view was stated by Bertrand Russell, *Power*, Chap. III.

[7] This assertion can easily be documented from debates in the House of Commons, *House of Commons Debates*, April 29, 1936; July 6, 1936; December 17, 1936. An excellent treatment of the control of British broadcasting may be found in Lincoln Gordon, *The Public Corporation in Great Britain* (New York: Oxford University Press, 1938).

as the police and the armed forces.[8] For the rest the formal government was merely called upon to act as umpire. The FCC, carrying on the policy of the FRC, is regulatory mainly in that it functions as a balancer of contending social forces. As the statute has it, it is to see that radiobroadcasting is carried on in "the public interest, convenience, and necessity." This pious formula provides an admittedly vague standard. Its very vagueness assists all those using it,—government agencies and broadcasters alike,—in rationalizing whatever compromise happens to be feasible between the prevailing balance of forces in the community. It is quite indicative of the general pattern of control in the United States that the labor group found relatively little opportunity to participate in the control of radiobroadcasting.

Radiobroadcasting has essentially become a business enterprise in this country. Although the Statute enunciates the people's general claim to the "air,"[9] it makes them pay for this "air space" by advertising. This situation has seemed acceptable to most people, because the cost is not realized; it is absorbed into the general price structure.[10] The result may be that those least able to pay for it, namely those who cannot buy a radio set, may be paying for the radio programs of those who can. Whether this seems "sound" policy depends upon the particular observer's social outlook; whether it is done that way in a given community will depend upon the pattern of control prevailing therein. It might well be argued that a system built upon greatly increased cost of radio listening apparatus might be more "just." The "American System" can claim to have led to a wider distribution of radio receiving sets than any other.

In this country the radiobroadcasters and the advertisers

[8] We say "government in the formal sense," because in a more realistic sense the community is of course governed by those who wield the power, whether they are called the government or not.

[9] It is amusing how this absurd expression persists amongst people who know perfectly well that the air, the chemical compound that we breathe, has absolutely nothing to do with the electrical waves emitted by the complicated machines built and operated by the radio broadcasting companies.

[10] Although in general there has been a substitution of radio advertising for advertising over other media, there are a few companies which have used radio to supplement other means of reaching the public. (Report by Neil H. Borden, Professor of Advertising, Harvard Business School, from studies in progress on this point). Figures on the increase in radio advertising, and the decrease in other media may be found in *Printer's Ink*, March 1, 1940, as compiled by Dr. L. D. H. Weld, Director of Research, McCann-Erickson, Inc.

who pay them for time on their stations between them decide what should go on the air. The broadcasters have developed a standard they refer to as "our editorial judgment."[11] Control is divided in a complex way between various interested parties. To explore that pattern is the task of anyone who wishes to understand the control of radiobroadcasting. The testimony of men participating in the conflict, though constituting important evidence, is never conclusive in such situations because of the working of the rule of anticipated reactions.[12] But certain tentative hypotheses can be formulated on the basis of a detailed study of advertising over the air. One finds here that a complex pattern has evolved in which the governmental agencies, Congress, the broadcasters, advertising agencies, and the manufacturers and distributors of advertised goods all share the power to determine what shall *not* be advertised. Congress, as representative of the total electorate, has in fact concerned itself primarily with matters pressed upon it by powerful organized minority groups, such as prohibitionists. This is in keeping with the general working of representative bodies today. The several "independent" commissions have imposed more general standards, but have been handicapped by the paradoxical conception of the various acts of Congress based as they are upon the logically contradictory notions of (1) no censorship (2) public interest, convenience and necessity. As it is not apparent how the broadcaster can be regulated in the public interest, convenience and necessity without considering what he broadcasts, and since such consideration may mean censorship, the FCC has vacillated between these two inherently incompatible goals of the policy as "defined" by Congress. However, when we come to what *shall* be broadcast we find that the broadcasters and advertisers have a fairly free hand, except in so far as they speculate on "what the public wants."

At this point, then, it is quite important to consider the role

[11] See e.g. "Political Broadcasts," an exchange of letters, published by the Columbia Broadcasting System in 1936. The intended newspaper analogy is obvious.

[12] The "rule of anticipated reactions" concerns the fact that it is difficult to trace control since the "person or group which is being influenced anticipates the reactions of him or those who exercise the influence." The rule is stated as follows: "Any political context in which we observe one or more instances in which a previous decision or action is reversed is likely to be permeated by the influence of the individual or the group to whom the reversal can be traced in the specific case." C. J. Friedrich, *Constitutional Government and Politics* (New York: Harper and Brothers, 1937), p. 17.

of the government, as an adjunct to listener "control." It operates, we might say, as a protection to minorities. Minorities, effectively organized, can make themselves very much heard in the antechamber of Congress. The moral judgments of the Catholic Church or of the "drys" are a case in point. But almost any group, even including labor, would be able to exert a measure of influence. It is not in the public interest . . . to have the general public disturbed, and hence the "independent" commission has the right to withdraw the license of a radio station which allows an uproar to develop. In turn, the broadcaster is ready to draw the line at this point. The rule in the Communications Act of 1934 on this point provides: "No person within the jurisdiction of the United States shall utter any obscene, indecent, or profane language by means of radio communication." (Sec. 326.) Broadcasters have defined specific types of material which they will not carry in addition to such obscenity, indecency and profanity. The National Association of Broadcasters, including 92 per cent of the industry's business, if but 50 per cent of its stations, has promulgated a code of self-regulation which makes it possible for the broadcaster to be fairly firm with enthusiastic promoters. The home, all agree, must be protected against irritating intrusions.

The general folkways, then, find an ardent champion in a set of regulatory institutions. They are thus protected because established business concerns do not wish to submit copy challenging the established folkways,—indeed the best of them are satisfied with a mere mention of the hallowed name of the great company on their sponsored programs. There are, however, considerable differences in the standards here involved, with the largest broadcasters usually the most conservative.[13]

Beyond this general pattern of balanced forces, only case studies can reveal something of the conflicts inherent in the American System. Typical conflict situations arise where a large number of listeners would like to listen to any of the programs under discussion, and the outcome of the struggle for control determines which one they actually listen to.

[13] This tendency for the big networks to be "high-class" was given very inadequate consideration in the "Monopoly Report"—"Report of the Committee appointed by the Commission to supervise the Investigation of Chain Broadcasting." Commission Order No. 37—Docket No. 5060. Also C. J. Friedrich, "The 'Monopoly' Report: A Critical Appraisal." *The Public Opinion Quarterly*, vol. 4, No. 3, September 1940, pp. 526ff.

The problems of the control of radiobroadcasting in the United States are reaching a crisis in the face of a possible war. Unlike the British and other people, we have developed our broadcasting facilities in keeping with a middle class controlled, property respecting democracy at peace. The control of radio has therefore largely been left to those interested in owning facilities hired by others and in those hiring the facilities. Is it safe to go on with that pattern of control?

When this study was first begun, there was no public discussion on the subject. During the summer of 1940, a number of suggestions were put forth, implemented by rumors in the trade journals. Broadcasters proposed that a member for communications should be added to the Advisory Commission to the Council on National Defense, while James Lawrence Fly, the Chairman of the FCC, wished to have a separate Defense Communications Board established.[14] The latter proposal has now become a reality.

On September 24, 1940, President Roosevelt announced the formation of the Defense Communications Board.[15] As originally announced, the Board's function was said to be "to work out 'paper plans' for use in the event of a national emergency, although it will unquestionably consider current problems having a bearing on national defense, such as international broadcasting, foreign language broadcasts, and the like."[16] Later reports said that the Board is to consider only the coördination of actual facilities and that problems of broadcasting and censorship are to be left to a Federal Information Agency, modelled after the Committee on Public Information.[17]

The War Department, however, has set up another and an apparently overlapping committee, in a separate radio section. The function of this section is said to be "to handle all radio liason during the current period of non-involvement. There

[14] "Communications Defense Board Projected," *Broadcasting*, July 1, 1940, p. 9. "Naming of Defense Board Imminent," *Broadcasting*, July 15, 1940, p. 13. "Neville Miller, James Fly Disagree on Best Way to Integrate Radio with National Defense Problem," *Variety*, July 17, 1940, p. 23.

[15] Its chairman is James Lawrence Fly, Chairman of the Federal Communications Commission. It includes the director of Naval Communications, the Army Chief Signal Officer, the Assistant Secretary of the Treasury (for Coast Guard), who also serves as Board Secretary, and the Assistant Secretary of State who is in charge of State Department Division of International Communications. *Broadcasting*, October 1, 1940, p. 11.

[16] *Loc. cit.*

[17] *Broadcasting*, October 15, 1940, p. 15.

is no censorship factor involved, at least not at this stage. The project is simply that of better coördination with radio and keeping the public informed." The radio section is to hire script writers and to plan for future developments in the case of actual conflict.[18] As yet, then, there is no obvious solution to the problem.

BASIC TASKS

This study is based on the premise that there are four basic tasks to be considered in determining how radio broadcasting should be operated and controlled during a war.[19]

> First, there are the military needs, which make radio an important weapon in the equipment of land, sea, and air forces.
> Second, there is the issue of morale, the building and maintenance of which is of unpredictable importance in modern technological i. e. industrial warfare.
> Third, there are the requirements of national defense against espionage, sabotage, and similar activities.
> Fourth, there is the task of maintaining good will abroad wherever we can, but more particularly in Latin America.

Each one of these tasks is an essential part of our war effort. If any one of them failed, the war might be lost. Hence a satisfactory policy of radiobroadcasting must seek to take care that all four tasks are adequately provided for. Many current views on the subject are the result of overemphasizing one of these tasks to the neglect of another. There are of course many conceivable alternatives, when one considers the course of action to follow, but these alternatives seem to fall into three major patterns. An outline of these follows.

MAJOR ALTERNATIVES

First, there is the proposal, supposedly indicated by the language of the Federal Communications Act of 1934, Sec. 606 (c), of putting the entire radiobroadcasting industry under the armed forces of the United States, with the three subalternatives of putting it (a) under the army, (b) under the navy, (c) under their joint control.

[18] *Ibid.*
[19] It is assumed that such a war will not, for a while, come to our shores.

Second, there is the possibility, also permitted by the Act, of taking over all radiobroadcasting into the government, but leaving administration to a civilian director-general, as was done with the railroads during wartime. If this alternative were adopted, there would remain the issue as to whether such civilian control should be linked with the Federal Communications Commission, with perhaps the chairman of the Commission in charge, or whether it should be given to a neutral civilian, an administrator outside the Commission, presumably directly under the President.

Third, there is the possibility of leaving the general broadcasting business as is, but (a) subjecting it to a measure of censorship, presumably under the censorship board of the army, and (b) commandeering as much broadcasting time as may be required by the government for its purposes. It may, however, be argued that censorship should be exercised by a civilian authority linked with a more general governmental control body, such as the Committee on Public Information. There are, of course, many different ways of commandeering time: The government could have definitely assigned time, say fifteen minutes every two hours, or could have the right to broadcast any time during stated hours (as is the usual arrangement between networks and their outlets), or both. If broadcasting is left as is, there is still the problem of adequate facilities for the government. As is well known, no existing chain has complete national coverage, and there are considerable rural areas which no station reaches effectively. There are a number of subsidiary questions: Whether to erect new stations or to increase the power of existing ones; whether to concentrate on long or short wave broadcasting.

It is necessary to point out, with regard to the last alternative, that the more recent development of broadcasting makes the actual programming the really crucial issue, from the government's point of view. A fair amount of experience has been built up by the small, but effective broadcasting activities which have been carried on by a number of governmental agencies, such as the Department of Agriculture and the Office of Education. Consensus of opinion among the men who have been carrying on these activities suggests the setting up of a central governmental programming service. Such a program-

ming service might restrict itself entirely to the task of developing program ideas and coöperating with the broadcasters in putting them on the air. Scripts and production might be largely the responsibility of the broadcasters themselves, or the Board might have to go into the business of building the programs. The division of activity would depend upon the attitude of the broadcasters.

These alternatives which are, of course, presented only in rough outline have their strong and weak points. An adequate consideration must inevitably weigh many intangibles, and hence remains to some extent a matter of opinion. But a general indication of the more obvious aspects may be offered here as a first step toward effective handling.

THE LEGAL FRAMEWORK

There can be no doubt that the language of the Communications Act of 1934 gives the President authority to take over the entire radiobroadcasting industry. Members of Congress who participated in the drafting of that legislation are inclined to feel that this action is intended by the Act. But if so, the language of the Act is equivocal; for it certainly does not make it imperative for the President to take over the broadcasting industry. The very fact that Sec. 606 (c) enumerates a number of alternative procedures, and begins with the provision "the President may suspend or amend, for such time as he may see fit, the rules and regulations applicable to any or all stations within the jurisdiction of the United States as prescribed by the Commission" suggests that this section is intended to give the President power to coördinate broadcasting control by the government, by substituting outright administrative control for the peace time control by an "independent" commission, responsible to Congress. But this action may, if necessary, be carried all the way to "the use and control of any station . . . by any department of the Government. . . ." In short, the legislation now in force leaves it entirely up to the President to go as far as he wishes. It contains no suggestions concerning the matter. Evidently, Congress recoiled from prejudging what might be the pros and cons of several alternative schemes. In doing so, it was undoubtedly wise, considering the rapid development of this new industry.

PROBLEMS OF ADAPTATION OF THE EXISTING SYSTEM

Rather than examine in detail the pros and cons for outright government operation of radiobroadcasting in this country, it seems best to discuss the problems involved in an adaptation of the existing system in order to discover what may be done. The greatest argument for such an arrangement is, of course, the maintenance of morale. The radio has become so much a part of the American home, and so much a constituent of the everyday way of life of the American masses that their morale can be most readily maintained by suitably utilizing this communication channel, not only for news, but for the effective dramatization of the war issues in serial dramas and other effective skits with high audience indices. Indeed, the withdrawal of such entertainment would seriously upset the routine of a considerable majority of the people, and thereby increase their sense of insecurity and lack of confidence.

Listening to radio has become a major feature of our folkways. A very sizable majority of people recently polled on the subject stated that they would rather give up the movies than their radio. Since morale depends in part upon maintaining as much as possible of the established everyday life, this certainly would suggest going on with broadcasting programs much in the accustomed manner. No doubt, ample time could and should be provided for the government, national, state and local, to reach the citizen and inform him about what is going on. Who should develop these programs is another matter. It is more likely to prove convincing, Americans being what they are, if as much as possible in the way of educational and informational material can be presented through channels not obviously governmental in nature. In view of the fact that most radio programming is at present being paid for by advertisers, either directly or indirectly, there is no good reason why this large expense should be added to the government's already crowded budgetary requirements. The extensive coöperation of station owners and advertisers with the government in the present National Defense effort points to the fact that in a national emergency broadcasters would go far in producing the "morale building" programs which the government would otherwise have to originate itself. After all, if we are in a war it's bound to be the people's war. It seems useful, therefore, to explore the necessary adaptations of existing broadcasting

facilities to wartime needs, in the light of available knowledge. This had best be done in reference to each of the four tasks we have described.

MILITARY NEEDS

The importance of adequate radio facilities for the armed forces of the United States is self-evident. Seeing that the air facilities are limited, and the needs of the armed forces increasing, persons not thoroughly familiar with the technical requirements envisage a shortage of "air space." In fact, no such shortage is anticipated. There is general agreement among experts (a) that the technical requirements of the armed forces must be fully met (b) that they can be met without seriously affecting the broadcasting setup as it exists today. Most army equipment for broadcasting between various parts of the forces uses short wave only. For technical reasons, these short waves are better adapted to such point-to-point broadcasting than long waves, and it is not contemplated that even with greatly increased demands on radio facilities in the event of a war the army would need long waves for its work. There is the possibility that for military reasons the army would wish to communicate with all the armed forces by long wave, but this could be arranged with the existing broadcasters since it is not likely that this would happen often.

For military reasons some long wave stations might have to be commandeered and put out of use for the duration of the war because of the dangers of directional flying. There would probably not be many such stations, however, and their loss to the listeners could be compensated for by service from other stations. British experience is of some interest here. It was known that British Imperial Airways planes flew in blind from as far away as Marseilles on the Drottwich long-wave beam. Before the outbreak of hostilities, the BBC consulted with the R.A.F. on how to eliminate this risk. Peace time alternative programs were eliminated and a single service substituted. Transmitters in various parts of the country were grouped in such a way as to "interfere" with each other sufficiently to eliminate directional flying. What this means for this country is probably a suitable patterning of matched channels at strategic locations which would scramble the signals sufficiently to eliminate the chances of using beams for directional flying. Only the strictly

military requirements in the light of qualified engineering advice should determine policy here.

COUNTERESPIONAGE REQUIREMENTS

This field lends itself to the lurid imagination, and fanciful dangers can readily be exaggerated to the point of absurdity. Yet with all due caution against that type of hysteria, it cannot be denied that radiobroadcasting in private hands, as it is in this country, presents certain possibilities of misuse. Information might, indeed, be conveyed to the enemy, in a considerable number of ways. Messages might be broadcast by ingenious codes which might be worked into songs and otherwise unobjectionable material. Furthermore, the experience to date with Fifth Column activity, hiding behind a variety of neutral fronts, makes close vigilance essential. Radio might be used, and in fact has been used, for communication between subversive groups in this country. It has also been claimed that use has been made of it for espionage purposes. To counter this, it has been suggested that an intelligence officer be placed in every radiobroadcasting outlet in this country. However, the existence of numerous listening centers would seem to make this kind of employment rather improbable in wartime, because of the danger of immediate detection.

On the whole, our long-wave stations are not well-adapted to convey information to the enemy, except along the coast and the Mexican border. Special safeguards may be introduced here. Some stations will have to be closed, or their power reduced. Broadcasters could be urged to coöperate in enforcing certain rules and regulations; those found to deviate from them could be deprived of their licenses.

The situation is markedly different in the short-wave field. Here the possibility of giving information to the enemy is technically considerable. However, there are only a relatively small number of such transmitters. If it were not for their utility as a means for carrying on efforts abroad, it might be simplest to withdraw these licenses altogether. It would deprive this country of its channels for reaching Latin America, allies, neutrals, and enemies, however, and this loss would appear to be greater than the gain of eliminating the chance of spies utilizing these facilities, if adequately controlled. It would not be difficult to install complete check-up in advance, as contrasted with mere

surveillance in the long-wave set-up. The stations could certainly each have an intelligence unit attached to them.[20] Considerable parts of the programs could be initiated in a government programming unit.[21] Commercial programming could be entirely prohibited. (There is little of it, anyway.)

FOREIGN LANGUAGE BROADCASTS

The foreign language problem is of no mean proportion in this country, with its polyglot population, many of whom are ardently attached to alien ideologies. But as has repeatedly been pointed out by qualified spokesmen, like Attorney-General Jackson, for precisely that reason we should be careful not to swell the ranks of the Fifth Column. Broadcasting has striking opportunities to help here through foreign language broadcasting. There have been some troubles, and certain station owners have been inclined to eliminate foreign language broadcasts. There can be no doubt that adequate surveillance is rather difficult. Yet we need the loyal support of Americans whatever their language. Rather than eliminate foreign language broadcasts altogether it might be wiser to reduce their number, and to substitute recorded material which can be carefully checked at a central point and shipped out over the country. When it comes to news, the government controlled short-wave stations could be utilized to furnish foreign language spots of brief duration (such as they are broadcasting today to countries abroad) which the local stations could rebroadcast.

NATIONAL MORALE AND THE PROBLEM OF DISSENT

Though we speak glibly of morale, we know very little about the conditions which make for high morale. That of the civilian population and of the armed forces merges to a considerable extent since the drive behind industrial production is so much a part of the fighting spirit of all, that we had better look upon the problem of morale as comprising soldiers and home forces. This is particularly true in view of the fact that it would be next to impossible to broadcast to the civilian population without reaching the camps, and vice versa.

It has always been recognized by able military leaders that

[20] These units would, of course, be under the Censorship Board.
[21] See below, pp. 392–395.

morale is of paramount importance.[22] Even an outright totalitarian system must do its utmost to maintain it. A democracy obviously cannot do without it. There are many elements involved in this effort, but no channel is probably today the equal of the radio. Hitler knows it, and has made masterly use of it. We must not do less, though our methods need to be very different. A totalitarian government seeks to eliminate every vestige of dissent. A democratic government, if it did likewise, would destroy its very foundation. Without responsible dissent and opposition, there could be no effective government with us. The BBC fully recognized this fact, and determined to secure enough latitude for responsible leaders of the opposition to make sure that no well-founded criticism would go unheard. But of course this recognition of the vital importance of criticism, and of the corollary danger of complete conformity, does not by any means imply that we can go on as we have. It is one thing for the qualified representative of a responsible group in the community to point to defects in the effort of those in power,[23] and quite another for a rhetorical agitator to offer general abuse. The issue here involved (and it is a very tricky one, to be sure) might be further illustrated by reference to Colonel Lindbergh: When he points out that our air arm equipment is unsatisfactory and ought to be improved in certain directions, it is probably well for the country to learn of his strictures, but if he comments upon the government's foreign policy, the same cannot be said.

There are many difficult questions involved in this type of proposal. The broadcasters, as part of their "editorial judgment," will do a certain amount of culling. But there may be need for explicit standards as to who should be allowed to speak, similar to the standards developed in the field of political broadcasting, which the Army Censorship Board may want to lay down, in collaboration with the other authorities and the broadcasters.

TESTING THE RESULTS

One very important task which the authorities will have to face is testing the effects of broadcasts. At the present time no

[22] For the issues involved in propaganda from abroad see below, pps. 398–400.

[23] Chamberlain and some of his ineffectual associates might still be in office, if there had not been this free opposition.

one is in a position to predict with any assurance what might be the reactions of various audiences to particular programs. Techniques have been developed and used by radio people to find out the effect of a single program. Little work has been done, however, in testing the effect of programs before they go on the air. When we consider the effect of such a broadcast as "The War of the Worlds," it becomes evident that one should avoid programs of an alarmist nature. The judgment of highly educated, sophisticated broadcasters may not anticipate the reaction of the mass of listeners. Another problem of obvious importance, if the war continues for any length of time, is the effect of programs on long range attitudes. For instance, the publication of losses during a particular battle may make people dissatisfied with the government at the time, but the fact that the government establishes a reputation for truth telling may be the best thing for morale in the long run. It would seem that the government should establish a service unit to deal effectively with this task. To avoid a lot of meaningless experimentation, however, such a service should be put in charge of someone with at least ten years' experience in the United States, and preferably someone whose work has brought him into contact with the common folks. Matters of this kind are very difficult to judge, and depend a good deal upon the groups dealt with. Effective work in this field undoubtedly requires a high degree of psychological insight. In view of the controversial nature of modern psychology it seems wise, however, to avoid any of the more extreme exponents of psychological schools, and to rely rather upon some fairly neutral persons. It is felt in many quarters that psycho-analytical and statistical fanatics are of dubious value for this kind of work.[24]

GOVERNMENT PROGRAMS

It is a striking argument in favor of continuing the present system with certain necessary modifications that a large number of the men who have been doing broadcasting work for various federal agencies are in favor of such a scheme. They feel, however, that peak listening hours must regularly be made

[24] An excellent treatment of the general problems of listener research may be found in Hadley Cantril and Gordon Allport, *The Psychology of Radio* (New York: Harper and Brothers, 1935); and F. H. Lumley, *Measurement in Radio* (Columbus: Ohio State University Press, 1934). See also Paul S. Lazarsfeld, *Radio and the Printed Page* (1940).

available for the government or utilized for public service programs. Since networks provide much larger and more certain coverage on commercial than on sustaining programs it will be desirable to make such public service programs subject to commercial rules, i.e. all outlets should be more or less obliged to carry these programs. It may be argued, and it has been argued, that the government should pay for such time at commercial rates, but this is a difficult issue. It clearly could not be so argued, unless the broadcasters were willing to submit to strict control of their returns so as to avoid any profiteering.

Some experienced broadcasters have expressed the fear that advertising revenue would materially decline in the case of war (as has happened in England). Hence, they urge, the government should step into the breach. At least one leading network executive, after a quick survey, felt that it would not be necessary for the government to pay for time on the air. Broadcasters would still be sound financially if advertising revenue dropped 30 per cent. More detailed statistics cannot at this time be offered. Further study may be desirable to anticipate any bad effect upon the industry.

At the present time, government agencies negotiate with the broadcasters for such time as they may be able to secure. They would be in a rather different position, if the government had definitely asked for a certain percentage of the time. It would then become necessary to allot this time between various government agencies so as to produce the most effective use of the available facilities. Although the broadcasters might attempt to deal with this issue, it is to be feared that they would find themselves confronted with conflicting demands of many agencies, and be placed in the position of umpires as to which had the right of way. This task might involve them in very delicate situations as it would presume that private persons would be the best judges as to what information was most essential and needed by citizens to enable them to play their part in the defense effort of the nation.

A CENTRAL PROGRAMMING AGENCY

Evidently a central programming authority should be created, if radiobroadcasting is to retain its basic structure. Such an agency would be in charge of radio programming for the government. It would initiate programs, and decide which radio

programs had the right of way, it would supervise in a general way the nature of such programs, it would attempt to assess their effectiveness by suitable testing methods, and it would keep in constant touch with the broadcasting industry concerning the entire government program. This would mean that such an agency could also suitably concern itself with making suggestions to the broadcasters as to ways in which they might assist the government in the maintenance of general morale. Such an agency would have to exercise control over the subject matter to be broadcast for all government agencies. This would be true even of those agencies whose work does not seem to be connected with the war effort in any immediate way, else such agencies would find it very difficult to get time on the "air."

If one keeps in mind the difficulties involved in effective programming at the present time, such an enterprise might produce serious difficulties, if it miscarried. If programs were ineffectual and uninteresting a good part of the time, people would not get into the habit of tuning in on public service stuff, and the government would presently be left without an effective radio voice. In this connection it might be worthwhile to cite the opinion of an expert who had much to do with radiobroadcasting for the Red Cross Drive recently:

> In our recent war relief fund drive, the leading network programs with the highest audience ratings, gave us an enormous number of plugs during the course of their regularly scheduled shows. The results were splendid.

This is not to say that the United States government at war can be put into the same category as the Red Cross making a drive. The Red Cross appeal was an extremely simple one: give, give, give. It merely had to get across its message of suffering and of help needed. The American government will have a rather complex appeal. Many situations will require extreme delicacy and discretion. It will not be able to rely upon humanitarian impulses. But precisely the complexity and the importance of the task counsel caution. They suggest the fullest possible utilization of existing resources of talent and ability fully familiar with the American listener.

This central agency, named perhaps the Radiobroadcasting Program Board would have to be staffed by specialists thor-

oughly familiar with broadcasting problems. In order to do this job effectively, such a Board would require some men fully familiar with the production of successful programs so that this authority would be in a position to implement departmental programs whenever such programs did not seem to insure maximum efficiency in reaching the listening public.

THE CONTROL OF THE PROGRAM BOARD

A difficult question arises in connection with where to put such an agency. From a strictly administrative standpoint, much is to be said for locating it right at the center, under the executive establishment of the President. A serious objection arises, however, from our system of party government. A great deal of thought was devoted in Great Britain to how to keep broadcasting out of politics. It has borne fruit and resulted in the establishment of an "independent" government corporation, but even this corporation was inevitably subjected to a certain amount of partisan pressure. In our country, where we do not have the same tradition of a recognized parliamentary opposition, it would be extremely difficult to organize the administrative set-up in such a way as to convince the people at large that the broadcasting channels were not being used for partisan purposes. Even the fairest administrator would be subject to continuous charges of abuse. He would appear to be very similar to a member of the cabinet. This would affect civilian morale most adversely. Brief reflection will convince one that even the President would be losing under such a setup, for the President will have all the time he wants on the radio, under any conceivable type of organization. As supreme commander of the armed forces of the United States in time of war all the broadcasting channels will be at his disposition. By putting the programming service directly under his control, he raises the spectre of partisan influence without any corresponding gain.

Even those who might be favorable to this solution on the ground of favoring governmental operation of radiobroadcasting as a public monopoly as it exists in Britain, should be wary of the expedient of using a war emergency for gaining control. The difficulties and complications arising during a war, including heavy curtailment of programs in certain respects, will be blamed upon governmental operations as such, just as they

were blamed upon the Director General of Railroads during the last war. This would very probably cause an unfavorable reaction in the public mind. In a democracy, such maneouvers for gaining an end not yet approved by the people at large usually end up by producing the opposite effect. This has been demonstrated by the fate of the prohibition amendment.

If the President should not control the Board, where should it be located? If some general Department of Public Information were set up[25] this national programming agency might naturally come under it. It has, however, been urged by one authority, especially familiar with recent British experience, that these radio programming functions should be clearly differentiated from the problems of government policy and propaganda. Hence, he urges, some body like the Creel Committee should be set up. It should be in intimate touch with this Radio Programming Board, but the Board should not be under the propaganda department. He feels it is vital to distinguish the functional preoccupations of a programming unit, concerned to give a radio form to governmental notions and needs, and of a unit preoccupied with government policy. Our knowledge is insufficient for a definite conclusion.

The Radio Program Board would probably function best, if in close touch with, but not a part of the Federal Communications Commission. Perhaps the Chairman of the FCC could be a member. Its Chairman and one of the other two members should be drawn from outside the Commission, however. For effective utilization of departmental and other outside views, it should probably possess an advisory committee, fairly representative of the ten or twelve agencies primarily concerned with national defense, the industry, the artists, and the listening public.

THE PROBLEM OF LOCAL STATIONS AND THEIR SIGNIFICANCE

Undoubtedly the most complicated problem in the administrative sense confronted by the Radio Program Board would be the coördination of local governmental programs and activities. There is no question that local leaders are of great importance in the maintenance of general morale. Yet the

[25] This might be the case. See the suggestions and blue print in James R. Mock and Cedric Larson, *Words that Won the War* (Princeton: Princeton University Press, 1939), pp. 344 ff.

experience of station WNYC, the municipal station in New York City, would indicate that local political dissension may make the work of the station very difficult. Where there is a less sincerely interested local leader than Mayor LaGuardia, local broadcasting may be even more influenced by political propaganda which destroys its usefulness in promoting morale. There must be further examination of the dangers and advantages of local control of broadcasting before this problem can be settled.

There are some who feel that we shall have to rely primarily upon network broadcasting. They would have us close some of the smaller stations. Equally experienced men would urge the exact opposite. Pointing to the fact that there are more independent stations than there are stations affiliated with chains, and that most of the affiliates operate independently of chain programs for a large part of the day, they would insist that the maintenance of local stations is of vital importance, indeed that "the real problem is how to use and how to allocate and how to control these hundreds of small radio stations throughout the country." Connecticut has put radio officials on its state defense board. That may be one effective method to tie in local activities. Those who maintain that local stations are very important realize that a large amount of decentralization would be indicated. "Successful execution would be in proportion to the degree of decentralization."

Experience with the coverage provided by networks on sustaining programs of mediocre interest is not a fair gauge of the relative importance of networks as contrasted with local stations. Small stations with limited program facilities are likely to be more hospitable to canned stuff of a governmental public relations department than the great networks. However, it all depends upon whom it is desired to reach. For total audience coverage all available facilities must probably be brought into play, though the available information about coverage is not as complete as it might be.

At any rate, there seem to be many good reasons for not shutting down the small local stations. In many areas they are extremely important for daytime reception. They do have their local following. Decentralized government agencies find them effective channels for communicating with their particular public, as contrasted with the national public, to which the

networks naturally address themselves. Many of the defense policies will be national in scope, and for publicizing them extensive coverage should be made available. Other policies will be addressed to particular groups which may be more effectively reached through local broadcasts.

At the present time the networks do not have national coverage on anything like the scale that might be required. Some well-informed observers feel that on that account we ought to increase the power of half a dozen stations to at least 500 kw. to give complete coverage. Certainly there is going to be an urgent need on occasion for reaching pretty nearly the entire nation (supplied with electricity). This is an old issue. It has recently been revived. The Chairman of the Senate Interstate Commerce Committee is said to be opposed to high power. At any rate, until we have such powerful stations, the effective local execution of defense policies will require the help of local stations. Indeed, even if we had such superpower stations, much effective local work would be greatly assisted by local stations using local personnel. The federal government may even find itself obliged to stimulate the development of broadcasting facilities in certain local areas where they are now wholly inadequate. It may be added that a considerable number of these local stations may in turn be linked into a supplementary emergency network. Indeed, the establishment of the Radio Program Board would in effect so link them: for what is a network but a national programming service?

ANTICIPATING A CRISIS

One striking advantage of the program service outlined in the preceding paragraphs would be its utility in building up a service personnel which would be available to the government in case conditions became more critical. If events should require it, as the war moved toward this hemisphere, machinery would be set up which would facilitate the control of all broadcasting facilities at a moment's notice. This might at first merely take the form of breaking in on all programs without delay. Such power must be placed at the disposal of the government, anyway. A great responsibility is thereby imposed.

In order that a complete coverage of the United States may be obtained instantly, which might be necessary in the event

of an emergency, it would be well to have provisions made for a hook-up of all radio stations. This could be accomplished by using the telephone lines which are already installed from one station to another in the networks, with additional lines to those stations not now provided with this equipment. In view of the technical uncertainties of rebroadcasting programs it would be safest to have such wire arrangements. However, such wire facilities would be difficult to build. These difficulties are great enough to recommend some other arrangement. At least as a beginning, there should be such an arrangement as the requirement that all local stations should continually monitor a medium-wave network station or a short-wave station and break into their programs to rebroadcast any announcement that came up after an agreed-on cue.

BROADCASTS FROM ABROAD

The problem of broadcasts from abroad has two aspects: (1) propaganda (2) espionage. There can be little question that broadcasts can be used to a certain extent in directing espionage activities here: Relatively harmless programs from a relatively neutral area could be used for giving signals and directions to spies and fifth columnists operating in this country. The simplest way to cope with such dangers would be to shut out all such broadcasts by blanketing them.

There is, however, also the problem of propaganda. Though the issue of propaganda from abroad by short-wave is not apt to be as serious as in European countries, it cannot be neglected by anyone concerned with radiobroadcasting in wartime. The British took a very bold stand and allowed everyone to listen to any and all broadcasts from the enemy. The result was the discovery and build-up of Lord Haw-Haw. How much or what he did to British morale, it's hard to say. There can be little doubt, from a variety of comments, that in this country Lord Haw-Haw prejudiced those whose general inclinations tended that way against the British and made those favoring them less sure of themselves. It has been asserted that Haw-Haw greatly strengthened peace sentiment in Britain at one time and another. Anyway, the problem is with us, when we consider the maintenance of morale.

One method, definitely available to us today, is the blanket-

ing[26] of all such propaganda. The British felt that their limited facilities did not make it advisable even in a technical sense. Our position is different. We have plenty of frequencies. While the British policy seems very high-minded, it would seem better for this country to prevent from coming in all but carefully supervised programs from enemy sources. The mass of American people are not sufficiently schooled in the wiles of European diplomacy to be able to cope with the lying distortions of Goebbels' organization. Once the harm is done, it is difficult to undo it. We want no Mr. American Neighbor to belabor our people and their history throughout this hemisphere the way Lord Haw-Haw has done.

This conclusion is strongly objected to by many on general grounds. They hold that it would be better for morale not to shut out the incoming propaganda. If such high-mindedness should prevail, and foreign enemy programs be allowed to come in, it would seem at least essential that all such program material be carefully recorded, as is now done to some extent by the Princeton Listening Center, and analyzed at once with a view to counteracting such audience reactions as would warrant the suspicion that serious damage was being done to our national effort. It is felt by those who would allow the enemy stuff to come in that there is a big gossip value in "instant rejoinder." Yet at least one very well-informed English authority comments: "Counteracting (rejoinder) is a forlorn hope. The first impact tells and takes no end of counteraction." There are great difficulties in the way to making such rejoinders effective. There is no way of insuring that even a majority of those listening to the foreign propaganda would listen to the "rejoinder." The considerable numbers of Hitler sympathizers in this country are continually being reassured in their attitudes by broadcasts, usually in foreign tongues. Ridiculing of American traditions and actions confirms these fifth columnists in their confident expectation of the day when they will be on top. It is very important to isolate these persons emotionally, to weaken their morale, as it were, and the shutting out of the

[26] "Blanketing" is effected by broadcasting a continuous noise or another program on the same frequency as the broadcast one wishes to block out. There are so many broadcasts directed by the enemy against England that it would have taken more stations than they had to block out all of them, which would have left no facilities for broadcasting to England itself. In addition, the problem is more complicated when the enemy broadcasters shift from one channel to another when they discover they are being blocked.

broadcasts of Hitler and Co. is the most decisive step in that direction. It may also be important not to call this enemy propaganda to the attention of people who never would listen to it otherwise. It is to be feared that the "rejoinder," no matter how instant and effective, would really broaden the range of listening to enemy propaganda.

PROMOTING GOOD WILL ABROAD

We have now come to the final and fourth task to be faced by our American broadcasting system in wartime, if it is to be fully adapted to national needs. It is a task in which we have only a limited experience. A certain amount of good will broadcasting has been carried on in Latin America by NBC, CBS, MBS, GE, and World Wide Broadcasting Foundation (financed in part by the Rockefeller Foundation), Westinghouse, and Crossley. This type of broadcast has been helpful, but inadequate, primarily because of lack of funds. Until very recently, the total expended does not exceed 500,000 dollars a year—whereas striking programs rivalling our own commercials would run into many times that sum, even in one language. Lately, Mutual has commenced broadcasting its regular programs in Spanish and Portuguese. Information to the effect that NBC and CBS are planning to do the same has been received.[27] However, even if such programming were undertaken, they could not solve the problem of coverage adequately. Considerable efforts would be required for systematically securing rebroadcast facilities. Many Latin American communities are quite inadequately provided with shortwave receivers. The establishment of the well-financed Latin American Division, under Mr. Nelson Rockefeller, promises effective work in this area before long. In addition to this work in Latin America, the several shortwave licensees have made limited efforts in other languages. NBC has gone farthest, devoting sixteen hours daily to broadcasting in six languages. NBC believes that it possesses a considerable listener following, but evidence in support of this belief is rather scant. To be sure, they have many nice letters, but they themselves know best that few American advertisers would accept such evidence as they have to offer.

[27] There is the additional problem that the broadcast output for North America may not be the kind of stuff the South American likes to listen to. Special programs must be developed with the South Americans in mind.

As in other forms of international communication activity, the task of broadcasting abroad must be differentiated, according to whether one is dealing with the enemy, with allies or with neutrals. However, this does not seem part of the specific problems of this study. It must suffice to state that all these activities are important for our war effort and need to be given facilities for broadcasting. Whether it would be sufficient in this field to rely upon commercial broadcasters to provide facilities for the program service of the government may be doubted, however. In shortwave broadcasting there are not available the large revenues which accrue to the broadcaster in longwave activity. Control must, anyway, be much more strict, as was pointed out above, when we discussed counter-espionage. If the government took over entirely the operating expense of these outlets, say 100,000 dollars a year per outlet, and provided for suitable amortization, say 50,000 dollars a year, it would have to provide only about a million dollars, and it would then be entirely free to make such use of these facilities as might seem best. At the same time, such an arrangement would leave the shortwave broadcasters free to resume their former activity after the war. These seven outlets could then be put into a shortwave broadcast chain (some hold their licenses only "experimentally" anyway) for the duration of the war, and might be made available as the nucleus of a nationwide government channel, in case of emergency,[28] with arrangements being planned for effective re-broadcast by local outlet on longwave.

Such an arrangement would give the government the opportunity to shape the output of shortwave decisively under the direction of the Radio Program Board. While it would still abstain from actual operations, it would convert those channels into agents (as contrasted with licensees), utilize their existing programming facilities to the utmost, but implement them on a considerable scale, wherever desirable, and regardless of commercial considerations.

[28] Elaborate technical changes must be made if short wave stations are to broadcast a signal which can be heard in this country. There was a note not long ago that it took six months for one of the companies to shift equipment from one channel to another. Perhaps these stations should be required to have their facilities ready for this emergency.

ADMINISTRATIVE PLANNING FOR NATIONAL DEFENSE*

O. L. Nelson

SUMMARY

THIS *analysis was motivated by the belief that the experiences of the War Department could be used to develop certain principles that could be applied to non-military administrative planning. At the present the course of events has focused attention on national defense, and planning for defense takes on new significance for it is the crux of our rearmament program.*

War Department experience with administrative planning provides an interesting field of investigation. Congress after a lengthy investigation of the confusion and ineptness which characterized the actions of the War Department in the Spanish American War enacted legislation providing for the creation of a General Staff which was to function as a planning and coördinating agency. The impact of a planning agency on an organizational system consisting of line troops (the operating combat forces) and the special administrative and technical services necessitated a reëxamination of military organizational theory.

The work of the General Staff since 1903 has resulted in many fine examples of intelligent planning. When contrasted with the previous practice of legislating in a piecemeal fashion, the National Defense Acts of 1916 and 1920 were comprehensive and reflected the influence of sound planning efforts. In addition to demonstrating what can be done, the experience of the General Staff planners indicates that there are certain basic difficulties which handicap and limit the scope of planning.

Planning for industrial mobilization, which was begun in 1920, is perhaps the most ambitious effort in planning yet attempted in the United States. Reviewing our war effort in 1917 and 1918, Congress realized the necessity of providing a special planning agency to work in this field. A survey of the problems encountered by the planners in

* This article was written with the idea that the experiences of the War Department could be used to develop certain principles that could be applied to all administrative planning. At the present, the course of events has focused attention on military planning. It is not an overstatement to assert that sound planning is the crux of our present national defense program. While this article refrains from any analysis of our present planning for national defense, it does possess a certain timeliness. An analysis of past planning efforts provides a background which is essential to an understanding of present developments. It is highly important to recognize the proper role of planning agencies and to provide an organizational framework which will permit them to function in their rightful place. Finally, instances of past failures and past successes in planning should prove useful in gauging the effectiveness of current military planning for national defense.

the Assistant Secretary of War's office provides an excellent case history which includes about all the difficulties any administrative planner could encounter. Of particular interest are the highly controversial political questions which impinge on planning activities.

THE EDITORS

PLANNING, like all popular catchwords, may mean practically anything. To many it appears as legerdemain invoked in a futile hope that thereby the growing complexities which confront government may be conjured away. Others have used planning as a convenient name for all manner of schemes ranging from dictatorial regimentation to utopian socialism. On the other hand, there is a substantial group who insist that planning must take the place of muddling through if our democracy is to handle effectively the difficult and far-reaching problems which confront it. With all the different associations of ideas which have attached themselves to the concept of planning, abstractions become meaningless or obscure. It is therefore proposed to examine the subject of administrative planning within a specific context—that of the War Department wherein a planning agency has been in existence since 1903.

At the outset it is well to examine the claim that War Department experience can be applied to other non-military administrative agencies. There are two potent reasons why the military should have pioneered in the planning field. The very nature of the military establishment is such that in peacetime it must spend a large part of its time planning what it would do in war time. Peace time conditions are such that learning by doing is difficult. There are many obvious reasons why war time performance cannot be simulated in time of peace. Because of this the only approach available to the War Department in preparing itself for the task for which it exists is to plan its training, maneuvers, and development in such a way as to approximate its war time functions. While this has made planning of great importance, it has also greatly complicated the problem of planning on the administrative level and focused attention on the relation of an executive agency and Congress. The other impetus to planning was the early establishment of a caree service for the professional army officer. In spite of these forces facilitating the introduction of a planning technique the position of the War Department is not unique. Certainly in the

extent to which Congress has gone in laying down detailed prescriptions how the allotted appropriations will be spent and what the particular duties of the various administrative agencies will be, the War Department occupies no favored position. Likewise, the opinions and recommendations of the professional soldier have never overawed our legislators. Instead, limited war service has convinced many of our lawmakers that they know as much as anyone else on the subject. Also, War Department planning has operated under a handicap not likely to be felt so severely by other departments. War Department planning and recommendations to Congress resulting therefrom—particularly those calling for greater expenditures—arouse strong suspicions of militarism. There is, in this connection, a useful but unwelcomed comparison between other bureaucrats and their military counterpart. All military proposals are rightly scrutinized by Congress to determine the extent to which plans for national defense are tinged by what might be called militarism[1]—the advancement or perpetuation of the military dictated purely by self interest rather than considerations of national defense. As other governmental departments establish a career service, their bureaucracy will be faced—but to a lesser extent—by charges of bureaucratism just as the military are accused of militarism. And finally, while reserving to itself jealously its constitutional obligation to enunciate and formulate military policy, Congress has been exceedingly slow, and in some instances has refused because of the political hazards incident thereto, to specify what our national policies and their military corollaries will be. Political opportunism has been inevitable in many instances. This situation is not peculiar to the War Department. To a comparable degree all of the major executive departments occupy a similar position. All are confronted, as is the War Department, with the necessity of anticipating by planning and thereby "to foresee a situation and evolve a solution which will break gradually upon the political consciousness and be sufficiently entrenched so that its formal adoption in the legislative chamber is not an embarcation upon an uncharted sea."[2] Because the War De-

[1] Cf. Alfred Vagts, *A History of Militarism* (New York: W. W. Norton and Company, 1937).

[2] C. J. Friedrich, "Public Policy and the Nature of Administrative Responsibility," in *Public Policy*, edited by C. J. Friedrich and Edward S. Mason (Cambridge, Mass.: Harvard University Press, 1940), p. 15.

partment established in 1903 an administrative agency especially charged with the function of planning, its experiences may prove of interest to other governmental departments.

EMERGENCE OF A PLANNING AGENCY

The present emphasis on planning in the War Department dates back to the Spanish-American War and the congressional investigation undertaken because of the confusion and ineptness which characterized the actions of the War Department in that war. For three decades prior to the trouble with Spain retrenchment in military expenditures had resulted in an increasing centralization of affairs in the War Department. The eleven principal administrative agencies into which the War Department was divided for administrative purposes withdrew more and more into what finally became water tight compartments. In theory each bureau chief reported to and was responsible to the Secretary of War; in practice each was virtually independent. Congress by specifying in great detail how the administrative agencies would operate created a condition wherein each administrative subdivision looked to Congress and its enactments as the sole directing and constraining influence. Where the possibility of effective supervision by the Secretary of War was present, the sheer number of individuals having direct access to him made the job most difficult. The situation was one wherein the individual officers were overwhelmed with routine matters pertaining to their particular narrow field. There was no time nor group of individuals whose duty it was to consider all phases of War Department policy or how the various component parts fitted together. Small wonder was it that Secretary of War Alger lamented that in 1898 "the governmental machinery was altogether inadequate to meet the emergency. It had, during thirty years, been called upon to plan for and meet the requirements of the regular army in time of peace, and naturally enough had become quite fixed in the narrow grooves of peace."[3] A commission of distinguished citizens, appointed by the President to investigate the conduct of the War Department in the war with Spain, reported:

[3] R. A. Alger, Secretary of War, *The Spanish American War* (New York: Harper and Bros., 1901), p. 7.

In the judgement of the commission there was lacking in the administration of the War Department during the continuation of the war with Spain that complete grasp of the situation which was essential.[4]

The task of remedying this condition was given to Elihu Root who relieved the discredited Alger as Secretary of War. The business of convincing Congress and the Army that reform was imperative was no easy matter. In particular, the bureau chiefs who had achieved success in the old framework were naturally opposed to any change which threatened to alter their position. Elihu Root's solution was to urge the establishment of a General Staff which would function as an agency for planning and coördination. His arguments for such a body are of interest for they reveal the kind of organization which he had in mind. In his 1902 report the Secretary of War stated:

The most important thing to be done now for the Regular Army is the creation of a General Staff. . . . We have the different branches of the military service well organized, each within itself, for the performance of its duties. Our administrative staff and supply departments, as a rule, have at their heads good and competent men, faithful to their duties, each attending assiduously to the business of his department.

But when it comes to the coordination and direction of all these means and agencies of warfare, so that all parts of the machine shall work together, we are weak. Our system makes no provision for the directing brain which every army must have, to work successfully. Common experience has shown that this cannot be furnished by any single man without assistants, and that it requires a body of officers working together under the direction of a chief and entirely separate from and independent of the administrative staff of an army (such as the adjutants, quartermasters, commissaries, etc., each of whom is engrossed in the duties of his own special department). This body of officers, in distinction from the administrative staff, has come to be called a general staff. . . . The most intelligible way to describe such a body of men, however selected and organized, is by calling it a general staff, because its duties are staff duties and are general in their character. . . .

It was the lack of such a body of men doing that kind of work which led to the confusion attending the Santiago expedition in the

[4] Report of the Commission appointed by the President to investigate the conduct of the War Department in the War with Spain, Senate Document 221, 56th Congress, 1st Session.

summer of 1898. The confusion at Tampa and elsewhere was the necessary result of having a large number of men, each of them doing his own special work the best he could, but without any adequate force of officers engaged in seeing that they pulled together according to plans made beforehand. Such a body of men doing general staff duty is just as necessary in time of peace as it is in time of war. It is not an executive body; it is not an administrative body; it acts only through the authority of others. It makes intelligent command possible by procuring and arranging information and working out plans in detail, and it makes intelligent and effective execution of commands possible by keeping all the separate agents advised of the parts they are to play in the general scheme.[5]

In 1903 such a General Staff as Elihu Root envisioned was established by Congress. Consisting of forty-five officers, it was designed to be primarily an instrument for planning and coördination. Having no power in itself, it was to function in an advisory capacity. So that its personnel would reflect the needs of the army and be conversant with what was going on in the army outside of Washington, the General Staff was to be constantly revitalized by new blood. This was to be accomplished by the provision that no individual could serve for more than four years on the General Staff; thereafter, he returned to his line branch and duty away from Washington for a period of at least four years. Only then could he be again eligible for General Staff duty. This requirement had the additional advantage of removing whatever dangers or handicapping suspicions might be attributed to a self-perpetuating or permanent planning body.

THE PLACE OF THE PLANNING AGENCY IN MILITARY ORGANIZATIONAL THEORY

It is useful to understand the place of the planning agency in military organizational theory before proceeding to the more practical consideration of how it has functioned. One cannot dismiss the matter by simply saying that the General Staff is the planning and coördinating agency of the War Department and that for the purposes of this analysis only the planning activities of the General Staff will be considered. To do so is to miss a crucial point misunderstanding of which has all too

[5] Report of the Secretary of War, War Department, *Annual Report*, 1902, pp. 292 ff.

often prevented a proper appreciation of the planning role. Elaborating on this theme, Colonel Palmer, testifying before the Senate Committee on Military Affairs in 1919, even went so far as to state that "one of the principal troubles with the general staff organization was that few persons know what the General Staff is" and that "this is true in civil life, in the army at large, and in the General Staff itself."[6]

Military doctrine emphasizes that there are three principal elements present in the organizational structure. At the base there is the line—the combat elements which are also called the operating units or the field forces. These are organized and designed to carry out the primary mission of the military—combat. Accessory to these combat or operating units are the service elements which perform such technical, supply, or administrative services as are needed to maintain the combat elements. Such services were originally performed by the combat elements themselves but with the growth of functional specialization there has been a steady increase in these auxiliary elements. At the top are command elements consisting of the commander and such assistants as are necessary to provide adequate control.[7]

An accurate conception of these three basic elements—line, service, command—is a necessary preliminary to the more misleading but commonplace grouping into the two general categories—line and staff.[8] While functional specialization has divided the line of the army into several parts, the term "line" denotes those operating agencies having combat missions. There is some area of disagreement as to the inclusiveness of the term "line." The Infantry, Field Artillery, Air Corps, and Cavalry are always included in this category as they are the basic operating agencies designed to carry out combat missions.

To render the line branches more efficient and to enable them to devote their entire attention to their combat mission, auxiliary services have been developed. Their mission is the performance "of such technical, supply, or administrative services as are necessary to maintain the fighting efficiency of the

[6] Army and Navy Journal, October 18, 1919, p. 199.

[7] Command and Staff Principles, Pamphlet, The Command and General Staff School (Fort Leavenworth, Kansas: The C. & G. S. School Press, 1937), p. 7.

[8] Cf. Luther Gulick and L. Urwick, *Papers on the Science of Administration* (New York: Institute of Public Administration, Columbia University, 1937), pp. 30, 57–67, 82.

combat elements."[8a] Thus, the Quartermaster Department has the task of providing the line with the important auxiliary services of supplying food, clothing, transportation, and shelter to the combat elements, the line of the army. Likewise, the Ordnance supplies military equipment, weapons, and ammunition; the Engineers maintain roads and bridges; and so on. To carry out these important auxiliary services, each specialized function has been organized into a structure which brings together all the various related elements. The apex of each of these functionally specialized organizations is in a War Department bureau under a Chief who is responsible for the efficient operation of his auxiliary administrative or technical service. To stop here, however, leaves a very incomplete picture. The officer in charge of each of the various sub-divisions occupies a dual role, misunderstanding of which has been the cause of many controversies in the Army. Operating a service which necessarily implies a vertical organization, the Chief of the War Department bureau exercises supervision throughout all the sub-divisions of his organization throughout the Army. At the same time the officer in charge of each sub-division of the special administrative or technical service is under the control of the commander of the appropriate echelon of combat units. Army doctrine emphasizes that authority must be given to the commander of the line forces—the principal operating elements—commensurate with his responsibility. This includes control over those service elements which render technical and administrative assistance, lack of control of which would prevent the military commander from operating effectively. To affect these controls, the officer in charge of the auxiliary service is designated as a special staff officer on the staff of the appropriate line commander. Thus, there is a horizontal grouping at each of the organizational levels. In effect, this places the auxiliary services under two masters—a situation which demands intelligent understanding. Properly appreciated, one can realize that no administrative principle is violated. The necessity of functional specialization dictates the one relationship; the requirement that responsibility for an assigned mission must be accompanied by the necessary authority governs the other. The concept of the position of the special staff has been confused through indiscriminate use of the term and through

[8a] Command and Staff Principles, *op cit.*, p. 7.

uncertain historical evolution. It is unfortunate that the word, staff, has been used as an inclusive term to denote both the general and special staff. The dichotomy is legitimate but confusing for it tends to merge the command and service element which are two of the three fundamental and separate elements in any military organization. The distinguishing characteristics of the special staff are that it renders routine auxiliary services which the commanders of the various echelons must control but which they are anxious to delegate to assistants in order to relieve themselves from burdensome routine. An important distinction to note is that special staff functions would be delegated even if the commander had the time to supervise such routine tasks himself. Subsidiary to the main task, such work should be delegated.

The General Staff as a concept arises out of the complexity of commanding a large organization. The command element at every level of the military hierarchy must reside in a single individual whose authority is commensurate with his responsibility. This authority and responsibility cannot be delegated. If all commanders of all military units of various size had the capacity personally to perform the planning, coördinating, and supervising duties incident to the exercise of command, there would be no justification for the existence of a general staff. Under such circumstances, however, you might still have a special staff to which routine administrative and technical services might be relegated. This was the situation that theoretically existed in the War Department until 1903. In practice, necessity forced upon the Adjutant General's Department and, to a much lesser degree, the Inspector General's Department the assumption of what may be properly called general staff duties.

Thus, while the General Staff does not absorb any of the perogatives of command, it owes its existence to the fact that the complexity of large organizations, and the attendant problems resulting therefrom, make it physically impossible for any one individual to exercise those functions of planning, coördination, and supervision which are indispensable in the exercise of intelligent command. To perform these tasks the commander of a large unit must have a General Staff which as a body acts as an *alter ego* of the commander. Such a body greatly enlarges the commander's capacity to command without absorbing any

of his attributes of command. Military doctrine emphasizes the fact that the General Staff officer has no right of command. Considering the General Staff as the commander's *alter ego* does not preclude sensible specialization on the part of the component elements. Thus, there is considerable specialization on the part of the War Department General Staff incident to the performance of its tasks in the field of planning, coördinating, and supervising. Henceforth, emphasis will be placed on the General Staff as a planning agency, an organization for thought, to use the terminology of Graham Wallas.

The organization of the War Department and the army may be briefly summarized. Divided into nine territorial corps areas, four overseas departments, and a General Headquarters Air Force, the army embodies desirable decentralization. The commanders of these areas and units report to the Secretary of War through the Chief of Staff. Each of these commanders has a small general staff and an adequate special administrative and technical staff. On the War Department level, the special administrative and technical staff consists of the offices of the Adjutant General, the Inspector General, the Quartermaster General, the Chief of Ordnance, the Chief of Engineers, and so on. Chiefs of line branches have been established but they form no part in the chain of command, functioning instead as inspectors of their particular branch of the line.

The organizational structure of the War Department has been indicated and the theory of military organization with its line, auxiliary service, and command elements has been emphasized because of the persistence of chronic misunderstanding as to what was the proper place of a General Staff planning and coördinating agency in the War Department. The most persistent criticism of the General Staff has been directed at its tendency to meddle in administrative details. Elihu Root realized that it was "important to avoid imposing on the General Staff duties of an administrative character,"[9] stating:

> I have always thought that one of the dangers to be apprehended in the working out of the General Staff system is the inevitable tendency to overload the (General) Staff with duties of this description. That would bring us back again to the position where we were

[9] (Letter of Elihu Root to Ainsworth) quoted by Philip C. Jessup, *Elihu Root* (New York: Dodd, Mead & Co., 1928), p. 262.

when the Assistant Adjutant Generals in the War Department were each doing a full day's work in administration and at the same time trying to do general staff work with the fag ends of their time and energy. . . . I think constant watchfulness should be exercised to avoid loading the (General) Staff down with matters which are really administrative.[10]

Despite this emphatic warning there seems to have been a chronic tendency for the General Staff planners and coördinators to meddle and to become enmeshed in administrative activity. Perhaps this is inevitable and confirms the suspicion that most individuals abhor the strenuous pastime of thinking and that routine details are sought as an escape. General Young under whom the General Staff first functioned admitted "that a certain amount of administrative work had devolved upon the several sections of the War Department General Staff."[11] The continuance of this practice played a prominent part in the struggle between the General Staff and the War Department bureaus which came to a head in the bitter fight between General Wood, the Chief of Staff, and General Ainsworth, the Adjutant General, in 1912.[12] This tendency again manifested itself during the World War in 1917 and 1918 when the supply, transportation, and storage bureaus of the War Department were completely absorbed by the General Staff's Division of Purchases, Storage, and Transportation. So persistently did the General Staff planners and coördinators invade the field of administrative routine that Congress in both the National Defense Act of 1916 and of 1920 prescribed that "members of the General Staff . . . shall not be permitted to assume or engage in work of an administrative nature that pertains to established bureaus or offices of the War Department."[13]

This most flagrant fault of the War Department planning agency emphasizes the necessity of understanding the proper place of planning in the organizational structure. As Colonel Palmer indicated, much of the trouble in the War Department stems from the failure to realize the proper spheres of the

[10] *Loc. cit.*

[11] Report of the Chief of Staff, 1903, Annual Reports of the War Department, vol. I, pp. 136–137.

[12] Cf. Report No. 508, 62nd Congress, 2nd Session, House of Representatives.

[13] National Defense Act of June 3, 1916, quoted in War Department Annual Report, 1916, p. 71.

command, auxiliary services headed by the technical and administrative special staff, and the line elements. Routine administrative duties fall within the province of the special staff. Their inability to plan with the fag ends of their time resulted in the creation of the General Staff. The General Staff planning agency, it must be remembered, is a part of the command element. If the Secretary of War or the Chief of Staff had the time and the means to do such planning, there would be no justification for such a body. But individuals in positions of authority rarely have this time. As Secretary of the Interior Franklin K. Lane once wrote, "I had thought perhaps, as a member of the cabinet, I would have an opportunity, say once a month or so, to think upon questions of statecraft and policy, but I find myself locked up in a cocoon—no wings and no chance for wings to grow."[14] It is this fact and this fact alone which requires the existence of a planning agency. Such a body serves to increase the capabilities of the responsible department head by performing those duties in the field of planning which intelligent administration requires but which the man at the top can never have the time to do. Assumption of other tasks and administrative routine duties not only destroys organizational clarity but ruins the planning agency, for without the necessary time and means which the deliberative function requires it is worthless.

EXAMPLES OF WAR DEPARTMENT PLANNING

To describe in detail the experiences of the War Department General Staff since 1903 as a planning agency would require a voluminous and tedious report. Only certain aspects and incidents revolving around the efforts of an administrative body to plan will be singled out and examined. It is realized, of course, that a distorted picture may result from such a procedure. By an artful selection of examples one could picture the War Department planning agency in whatever light one desired. In the analysis which follows an effort has been made to present a typical cross-section which will reveal both favorable and unfavorable elements. Likewise, examples have been chosen from among those activities which have a parallel in other governmental departments.

[14] Franklin K. Lane, *The Letters of Franklin K. Lane* (New York: Houghton, Mifflin Co., 1922), p. 138.

Even the most casual examination of the functioning of the War Department during the last three and a half decades reveals how essential a planning agency has been. Practically every annual report of the Secretary of War and the Chief of Staff of the Army has paid tribute to the General Staff as an indispensable instrument for planning and coördination. William Howard Taft in his report as Secretary of War in 1904 stated:

> I strongly approve the institution of the General Staff. Its work for one year demonstrates its utility. Experience will doubtless suggest useful changes in the details of its operation, and a somewhat more exact definition of its jurisdiction; but no one at all familiar with its advantages will ever think of recommending its abolition.[15]

In 1905 the Chief of Staff in his report observed that "since the date of my last annual report the General Staff Corps has again abundantly demonstrated the wisdom of its creation."[16] In 1906 the acting Secretary of War remarked that "we cannot see how we ever did without an Army General Staff."[17] Equally commendatory opinions were voiced by nearly all the succeeding Secretaries of War. Likewise, such prominent army officers as Generals Wood, Scott, Pershing, Harbord, March, Summerall, and MacArthur have many times in their reports expressed their indebtedness to and appreciation of the General Staff for its planning and coördinating activities.

PLANNING VERSUS PIECEMEAL LEGISLATIVE ACTION

One of the most striking incidents which revealed the need for an over-all administrative planning agency in the War Department occurred in 1907. That year marked the high tide for disjointed efforts on the part of various elements of the army to secure legislation from Congress. Perhaps because promotion operated on the basis of seniority within each branch and service, each of the various component parts of the army was continually putting forth the proposition that their particular part of the army was in dire need of a substantial increase or

[15] Report of the Secretary of War, War Department Annual Reports, 1904, p. 19.
[16] Report of the Chief of Staff, War Department Annual Reports, 1905, vol. I, p. 369.
[17] Army and Navy Journal, October 13, 1906, p. 179.

that the interests of national defense could best be served by an increase in their arm or service even at the expense of the rest of the army. The activity went further than mere idle words. By using all possible methods of influencing Congress and the public, all sections of the army sought to promote their own particular aims. In some instances such activity accomplished its purpose, for Congress habitually dealt in a piecemeal fashion with army problems. Whatever element of the army could clamor the loudest or had the most effective contacts with congressional leaders was the one that received congressional attention. Thus on January 25, 1907, the President signed a bill which provided for the permanent separation of the coast and field artillery and which provided substantial increases in both. There were of course good technical reasons for this action. The Field Artillery, it was argued, was an element of the mobile army and closely related to the other line branches while the Coast Artillery was responsible for the operations of the fixed defenses of our coast. A more potent reason in the minds of artillery officers was the prospect of rapid promotion. One army officer, now a Major General, retired, and then a junior artillery officer, stated that the motivating force behind this legislation was the prospect of increased rank. At least, the other branches of the army suspected with some justification that the change had been engineered by artillery officers on duty in the War Department for the sole purpose of providing more rapid promotion. At this time the Cavalry felt that Congress was ignoring their needs and that increased appropriations for the Coast and Field Artillery were being made at their expense. The Infantry, too, was disgruntled. "Since January 1, 1898, many regiments had spent more than half their time in a tropical climate, and, as a result, insufficient time was given in the United States for the officers and men to recover from one tour of service abroad before another began."[18] The hardships of foreign service, the slowness of promotion, and the spectacle of watching their West Point classmates in the Coast and Field Artillery advancing rapidly naturally irked the infantry officer. As a result, Congress was approached by many groups who each represented a part of the army. While some legislation resulted, the usual result was that Congress did nothing in the face of such conflicting and often directly opposed views.

[18] War Department Annual Reports, 1907, vol. I, p. 356.

That this practice had grown to a point where it constituted a major obstacle to the proper consideration by Congress of the army's needs was realized by the Chief of Staff. In his report for 1907, General Bell strongly emphasized that:

> It is undesirable to continue increasing the army piecemeal. It is this method which has resulted in making the present organization so unsatisfactory. Increasing one branch of the service at a time also results in great inequalities in promotion, and by thus upsetting relative rank, based on length of service, tends to destroy that cordial feeling of good will and comradeship among officers of different branches which has always been peculiarly characteristic of our Army. . . .
>
> The question of a proper reorganization of the entire army is one worthy of thorough and systematic study. A comprehensive plan . . . should be prepared and made known to the Army. Opportunity should be afforded all officers to present their views to the War Department upon the subject.[19]

SCOPE AND LIMITATIONS OF PLANNING

It must be admitted that the General Staff planning agency has not obviated all difficulties. Over-all planning has not completely replaced piecemeal action. The War Department General Staff has recognized that this is a field of study which can only be handled by the planning agency operating as the *alter ego* of the Secretary of War and the Chief of Staff. In preparing the War Department program for submission to Congress, the General Staff planning agencies habitually call upon the various line arms and the special administrative and technical staff for recommendations. The final and most important step is the weighing of the various recommendations and the elimination of those items which are either conflicting or not in harmony with what seems best for the army as a whole. While such a procedure is necessary if an integrated and intelligent program is to be recommended to Congress, there are still many who object to such methods. Short circuits still occur in that individuals or groups in the army still have contacts with members of Congress. Likewise there have been protests both by Congressmen and army officers that the General Staff planners should not be permitted to reconcile conflicting views emanating from the various sub-divisions of the army but that

[19] *Ibid*, p. 197.

Congress should hear all views and do the reconciling. Illustrative of this controversy was the experience of the War Department in presenting recommendations to Congress on the reorganization of the army in 1919 when the transition from a war to a peace footing was under consideration. Shortly after the Armistice the War Department General Staff was assigned the task of studying the entire problem and of drawing up recommendations which could be submitted to Congress. Everyone of course admitted that the lessons of the war should be carefully studied and used as the basis for an intelligent military policy. Likewise, the great majority of experienced observers realized that very diligent study was necessary to determine what should be adopted from the tangled web of past experiences and what important innovations were indicated as a result of the world war effort. But here agreement ceased. All interested parties admitted the foregoing as a premise only if they were to be allowed to do the planning.

The Chief of Staff directed the War Plans Division of the War Department General Staff to formulate a bill for the reorganization of the army. Incident thereto, the head of each administrative and technical service and bureau and the various operating agencies were directed to submit their recommendations on the proposed measure. Presumably, everyone who had a significant part in the military establishment had an opportunity to submit a proposal and to be heard. Pursuant to its directive the War Department War Plans Division had no alternative but to weigh these various recommendations and to then decide to what extent they should be incorporated into the War Department proposal. Both the bureau chiefs and Congress resented this assumption of authority. In 1919 both houses of Congress commenced hearings on the War Department reorganization. In the course of these hearings many army officers had the opportunity to make known their dissenting views. Major General George Squier, Chief Signal Officer, testifying before the Military Affairs Committee of the House of Representatives on October 2, 1919, stated that the Signal Corps was not at all satisfied with the provisions of the War Department bill.[19a] Replying to a question from the committee, General Squier related "that beyond the holding of several consultations with General Staff committees, the officers

[19a] Army and Navy Journal, Oct. 11, 1919, vol. 57, p. 167.

of his department had had no part in formulating the policies included in the bill. Practically all the recommendations made by them had been overruled."[20] General Squier's attitude was echoed by other bureau chiefs and line officers who were called before the House and Senate Military Affairs Committees. The necessity for planning was everywhere emphasized but each agency wanted to do its own planning and resented any modification or pigeon-holing of their recommendations short of the final determining authority, Congress. With respect to the War Department recommendation that increased authority and a greater area of administrative discretion be accorded the War Department, Senator Chamberlin, reflecting congressional suspicion of the General Staff as an instrument of planning and coördination, thumpingly declared, "This preposterous scheme, together with many others of like intent in the pending bill, spells one man dominance, staff despotism, and militarism to a degree never surpassed in the palmiest days of the 'Great General Staff' of the German army."[21]

To complete the picture, the further difficulties of the War Plans Division in 1919 must be mentioned. When they completed their work and submitted their report to the Chief of Staff, General March, the Chief of Staff was annoyed because the General Staff "had gone far beyond the principles outlined to them"[22] and had produced a plan which General March would not accept and would not submit to Congress. The Chief of Staff revealed that the final bill was "licked into shape by a committee consisting of myself (General March), General Goethals, the head of the War Plans Division, the head of the Operations Division, the head of the Military Intelligence, the heads of the different divisions of the General Staff, which sat nights after the preliminary work down below: and after we got through that, we had several hearings with Mr. Baker and Secretary Crowell and met in his office for two or three nights."[23] In rejecting the work of the War Plans Division, General March unconsciously departed from a principle which he had previously supported with great vigor. March had persuaded Baker during the war to do away with the War Council which

[20] *Loc. cit.*
[21] Army and Navy Journal, *op. cit.*, Sept. 20, 1919, p. 71.
[22] General Peyton C. March, *The Nation At War* (Garden City, N. Y.: Doubleday, Doran & Co., 1932), p. 331.
[23] Senate Hearings, 66th Congress, 1st Session, Aug. 8, 1919, p. 84.

had been composed of the various bureau chiefs. He had argued then that planning and coördination were functions of the General Staff and if there was any fault with that agency, its personnel should be replaced for the theory of the structure was sound. But once you were sure of your men, you must perforce give them wide latitude. That was the essence of the staff relationship in the matter of planning. March's action raises an interesting question. Presumably, a planning agency is a thought organization. If such is the case, only the facts and the dictates of right reason would be considered as the basis for recommendations. To what extent, then, can a planning body be instructed or directed in advance with respect to its conclusions? If the department head has arrived at a decision, he may well submit it to the planning group so that its soundness may be tested. However, if a decision has been made and if the planning group merely fills in the details or seeks to justify the position taken, there then is a perversion of the planning function. A complicating factor enters in that recommendations can rarely be based on purely rational grounds. When irrational elements predominate, planning both in theory and practice becomes difficult.

The situation in the War Department in 1907 and in 1919 indicates both the scope and limitations of departmental planning. Several observations seem obvious. One is that piecemeal uncoördinated action on what is naturally a unified program is highly unsatisfactory. On what is at best a highly complicated problem, an integrated well-planned program is essential. To provide such a recommended program a central departmental planning agency, unbiased by affiliation with any operating agency or any administrative or technical special staff bureau, is needed. Unless there is some such program, well stated and developed, and backed by a departmental united front, Congress is apt to act indifferently or not at all.

In theory, the presence of a planning agency presents an effective pattern. In matters affecting a department, the responsible head calls for recommendations from the operating line agencies and the administrative and technical special staff. These reports are turned over to the planning agency which, freed from routine, may deliberate over them in a way which the department head would like to if he had the time. Conflicts are reconciled and an integrated program is recommended to

the chief. If the personnel has been properly selected, the recommendations are those which the department head would have reached, had he the time to study the matter carefully. Congress then accepts the basic recommendations because they represent the best and soundest thoughts on the subject.

In practice, such a pattern will seldom be followed. It is inevitable and perhaps desirable that subordinate agencies and individuals will have contacts that will short circuit the procedure outlined above. Likewise, Congress will and should from time to time probe into a department and secure information and recommendations from the various organizational levels. However, these practical limitations do not invalidate the procedure. Some planning agency, whatever its title may be, seems necessary. Congress has the right to obtain the best integrated thought from a department as the basis for its further deliberations. Whether Congress adopts, ignores, or radically changes departmental recommendations is another matter.

Army organization, territorial decentralization, and army post construction represent fields in which the planning agencies of the General Staff have done much work. There are some interesting aspects of this work, particularly in those instances where administrative planning has collided with congressional interests.

During General Wood's regime as Chief of Staff, much attention was directed to the problem of army organization and the question of proper territorial distribution of the army. Incident to the development of the West, the army had been scattered in many small posts much like constabulary. Intermediate between the seventy odd military posts and the War Department was the territorial department which had jurisdiction over all posts located within its territorial limits. The location and strength of the various posts had long been a matter of some concern to the Congressman and Senator from the locality in which the garrison was situated. Likewise, the department headquarters, situated in the principal city of the area, was of some political consequence. Prior to 1911 considerable attention had been devoted to the problem of developing a mobile army which required the grouping of small units into larger sized commands. General Wood's interest in a mobile army and the complete integration of all tactical units

into their proper place was exhibited almost as soon as he became Chief of Staff. Shortly thereafter, he created the Mobile Army Division of the General Staff which was charged with the task of working out the necessary plans to perfect such an organization.

As a part of the program, the General Staff planners recommended that several territorial departments be grouped in a division and on May 19, 1911, the War Department directed that the ten departments be grouped to form four territorial divisions. The departments were not abolished but in the process of establishing division headquarters as the office immediately responsible to the War Department, the department headquarters appeared likely to suffer both in strength and in importance. The Senate immediately became interested and by a resolution adopted on June 1, 1911, called upon the Secretary of War to furnish the Senate with a statement of reasons for the proposed reëstablishment of division headquarters which was to become effective on July 1, 1911, if the War Department order remained in effect. This produced a very fine study from the General Staff which was printed as Senate Document 42 of the 62nd Congress, 1st session. Because this report exemplified so well the planning activities which the General Staff was brought into existence to perform, a brief summary will be given. A substantial part of the report was devoted to tracing the history of the army's territorial organization, appending thereto all the historical documents relating to the various changes. The reasons for the proposed change were enumerated in great detail and the economies to be effected were outlined in specific terms and in dollars and cents. A map was included which showed graphically the effect of the changes. Finally, a survey was added showing the probable effect of the new territorial organization and its bearing upon cities in which department headquarters were located. The purpose of this was to show exactly what differences in office space and rents and in personnel and funds spent in the various localities would result from the proposed change. Of interest was the statement that "history shows that territorial divisions, not considering the Philippine Division, have been in existence and discontinued during six periods since they were first created in 1815; that of the 95 years from 1815 to 1910, divisions in the United States

have been in existence 52 years and discontinued during 43."[24] This recurrent change, swinging back and forth six times in the same pattern, carries with it the presumption that former changes were not very well thought out.

PLANNING AND POLITICAL CONSIDERATIONS

As an outgrowth of the effort to establish a mobile army organization, the Secretary of War petitioned Congress for authority to abandon obsolete, small sized army posts and to plan for the concentration of the army in a few large posts. Here the General Staff planners ran afoul of politics. The House of Representatives intervened calling for a complete report.[25] The report submitted demonstrated once more the utility of a General Staff planning agency. This study[26] of the distribution of the army of the United States and of the posts which had been established in localities for reasons which were justifiable a half century ago but ridiculous in the twentieth century revealed how haphazardly army stations had been selected and maintained. The plan presented a long time program in which certain stations were earmarked for abandonment as soon as adequate facilities could be provided in localities for which there existed a military justification for the location of troops.

Here was sound long time planning. Unfortunately, Congress had other ideas as to how funds should be apportioned for the construction of army posts and their maintenance. Congressmen and Senators were generally unwilling to see appropriations curtailed for posts located in their bailiwicks, much less assent to their abandonment. Singularly enough, the General Staff study on the location of army posts discussed the failure of the army to adopt an intelligent housing program and attributed the causes to lack of appreciation of the problem on the part of the army itself, to the necessity of housing troops returning from the Philippines which in the interests of economy caused many abandoned posts to be re-garrisoned, and to local and political conditions which were traced in considerable detail. The study included a recommendation of posts to be abandoned, some eighteen being listed for early abandonment and seven

[24] 62nd Congress, 1st session, 1911, Senate Documents, vol. 28, Document 42, p. 10.

[25] House Resolution 343, 62nd Congress, 2nd session.

[26] House Document 490, 62nd Congress, 2nd session.

being tagged for eventual elimination. It so happened that Senator Warren of Wyoming was Chairman of the Military Affairs Committee of the Senate. Of the eighteen posts listed for early abandonment two whose total cost to date had been slightly over two million dollars were in Wyoming. Of the seven listed for eventual disposal one, Fort D. A. Russell (now renamed very appropriately, Fort Francis E. Warren) had had $4,925,486.15 showered on it for construction purposes alone. This report naturally antagonized Senator Warren and others similarly situated. It proved to be one factor which with others of a like nature persuaded Congress in 1916 to consider seriously a proposal to eliminate the General Staff.

The army geographical divisions and departments remained although they later gave way to the comparable organization which exists today—field army areas and corps areas. The program to concentrate the army in a few large posts failed to make much headway. The congressional reaction to the report was discouraging to the planning agency. In the conference between the House and the Senate on the Army Appropriation Bill a provision was added which created a commission of five retired army officers, specifically designated by name, and two members from each House of Congress to report upon the location and distribution of army posts and forbade the President meanwhile to make any changes whatsoever in the existing posts. Of the twenty-five posts slated for eventual abandonment in 1911, seventeen were still occupied in January, 1940.

Planners may well contemplate this case. On the question of where military posts were to be located, what factors were relative to the General Staff study? No doubt General Wood and the planning agency of the General Staff had prided themselves on their complete objectivity. Only considerations of economy and military strategy were accepted as determinants. Such a viewpoint was admirable and no doubt was to be expected of a politically neutral career service. Yet such a policy can be questioned although it leads to an uncomfortable dilemma.

Planning cannot take place in a vacuum. Political expediency was bound to be an important conditioning factor. To disregard it or ignore it was to neglect a phase of the problem which was just as important as any of the other factors. Taking it into consideration, however, alters the concept of a neutral

administrative planning agency. A hardboiled attitude would hold that any planning agency that was any good would start with all the non-political factors in order to formulate a program to which could be added or from which could be subtracted sufficient items to provide a coating of political allure sufficient to induce its acceptance by Congress. Taking political factors into consideration alters the concept of a neutral administrative planning agency. Once such a body included in its estimates the necessary political scheming to put the measure across, one can argue that the administrative level has been transcended. Likewise, such an approach ushers in all sorts of irrational factors whose presence, it has already been noted,[27] makes planning most difficult.

There is, however, a more comfortable view that may be taken. One may claim that at least the General Staff planning agency presented the problem to Congress in a comprehensive and impartial manner. That Congress chose to ignore this study is not to be deplored for that is not only the privilege but the duty of Congress. Perhaps this point is unduly belabored but its importance warrants its repetition. Had a War Department planning agency not existed Congress would probably never have had the opportunity to exercise its prerogative of accepting or ignoring the recommendation. Congress would not have the time nor the technical and intimate knowledge necessary to produce a substitute. Individual members of Congress could certainly not be expected to display much zeal in this field. Little political capital could be gained; on the contrary, it would be hard to discover an easier way to store up future trouble by alienating various members of Congress, whose constituencies included posts slated for abandonment. And in addition, even if Congress apparently ignores a recommendation of a planning agency, claim may be made for its long time influence if the recommendations are sound. Thus, as time has passed, army appropriations have yielded to the logic presented by the General Staff planning agency and the army is being concentrated in larger posts. One further point may be mentioned. Even in this field the utility of a specialized planning agency may be pointed out. Only such a body could bring together and properly correlate all the items that had to be considered. For example, the Quartermaster General's Department, a special staff agency, was charged with the carrying out

[27] See above, p. 419.

of new construction and the allotment of funds for needed repairs and ordinary maintenance. The request for repair funds came from each of the various post commanders, all of whom naturally considered only the immediate problem in isolation from all other posts and from future developments. The Quartermaster General, in the absence of such a planning body, had to rely on his own judgment as to what the future trend would be. Being a technician rather than a tactician, he was unsuited for such a task. Only in a central planning agency could all the tactical and technical factors be tabulated and scrutinized and a final plan assembled in which each of the pertinent factors would be accorded its proper weight.

PLANNING AGENCIES AND PROPAGANDA MACHINES

One episode occurred during General Wood's tour as Chief of Staff which deserves mention for it illustrates how a planning agency can be perverted into a propaganda machine. It will be recalled that General Wood had been preaching on the dire need for more adequate preparedness for a number of years prior to his appointment as Chief of Staff. He felt so strongly on the subject that he had all the zeal of a religious crusader. The fact that his estimate of the situation proved to be correct in the light of the events which followed a few years later is beside the point so far as this analysis is concerned.

Prior to the time General Wood arrived in Washington for duty as Chief of Staff, President Taft had advised Congress that he would shortly submit a special message on the subject of national defense. Considerable delay ensued and before the message was delivered, the House of Representatives adopted a resolution[28] calling upon the Secretary of War to report on the question of national defense. Wood assumed office as Chief of Staff just in time to take charge of the preparation of the report. The McLachlin Resolution was just the vehicle Wood wanted. In fact, McLachlin was a great friend of the army and offered the resolution "at the instigation of some infantry officers"[29] who were anxious to have the country learn the true state of our defense preparations. Here was a job that was given to the General Staff planning agency that could not be handled in a

[28] House Resolution No. 707, 61st Congress, 2nd Session.

[29] General Johnson Hagood, *The Services of Supply* (New York: The Houghton Mifflin Co., 1927), p. 71.

restrained manner. Scare headlines were demanded by the directive given it.

Secretary of War Dickinson fully approved the War Department approach and the answer to the McLachlin Resolution revealed bluntly how deficient "the regular army was in numbers, in reserves of field guns, supplies, and projectiles for the coast artillery, in the organization of the quartermaster's department and the commissary. It lacked the various arms; it was not organized into brigades and divisions essential in case of war. The militia was in even worse condition, deficient in training and physical stamina, lacking arms and numbers and proper organization. 'It is apparent that we are almost wholly unprepared for war . . . that the things we need will take longest to supply.' The Answer ended with an appendix of devastating statistics."[30]

General Wood did not rest with the mere presentation of a forceful answer. He personally took a copy of the Answer to the Resolution to the White House, giving it to the President's Secretary with the urgent request that the President read it before preparing his annual message to Congress. As the "envelope had been marked ***Important*** and as the Secretary to the President had assured Wood that it would reach the President's eye,"[31] General Wood, hearing no reverberations three days later, "secured permission from the Secretary of War to have copies sent to the leading press associations, so that the newspapers would have the Answer to the Resolution in complete form for publication the day after it was presented to Congress, and would not be dependent merely on the brief excerpts that would be sent over the wires."[32] Unfortunately for Wood's plans, Representative Tauney, Chairman of the Appropriations Committee, heard about the contents of the Answer and immediately got in touch with the White House to see if the President had approved "this conspiracy on the part of the army to create a flurry in Congress and secure larger appropriations"[33] by *frightening the country*. The President had not been given the Answer by his secretary. The upshot of the matter was that the President knew nothing about the contents of the

[30] Hermann Hagedorn, *Leonard Wood, A Biography* (New York: Harper and Bros., 1931), pp. 101–102.
[31] *Loc. cit.*
[32] Hagedorn, *op. cit.*, p. 102.
[33] *Loc. cit.*

Answer. On reading it, he vetoed the whole project because it was politically inexpedient. The copies distributed to the press had to be recalled. The whole affair was soft-pedalled after Taft had rebuked both Wood and the Secretary of War. This affair focuses attention on several major errors.

Wood had believed that could the people of the country only have known the true state of our national defense, their reactions would have been such as to force Congress to adopt the War Department's defense program. Ignoring all other factors in the situation, one may severely criticize General Wood and the General Staff planning agency for omitting a very vital factor from their considerations—a conditioning item which condemned to certain failure the whole business from the very start. The planners had failed to keep in tune with the times. The mid-term elections had gone against the White House and the party in power. The high cost of living was the topic of the hour and the people of the country were acutely conscious of their pocket book and the demands that were made on it. With such a background, an hysterical appeal for more funds for national defense with its obvious implication of higher taxes could only have met a very hostile reception from the people of the country. It was fortunate for the War Department that this project was halted before it reached the country.

The greatest error resulted from the failure of the administrative planners to understand their proper relationship to Congress. The idea that Congress could be high-pressured into adopting the dictates of an administrative agency was preposterous. Even if the War Department had been successful in this instance in bludgeoning Congress into carrying out the program, it would have lived to regret the incident. Even more fatal was the resulting lack of confidence in the War Department General Staff as a planning agency. No matter how thoroughly subsequent matters were studied or how judicious were the recommendations of the General Staff planning agency, its activities were highly suspect by Congress. Its usefulness was seriously endangered and in 1916, at a time when planning services were greatly needed, the General Staff in Washington was reduced from forty-five to twenty.

Although the General Staff was viewed with suspicion by Congress from 1912 on, it continued to function with increased efficiency as a planning and coördinating agency. A very ex-

cellent illustration of the type of work in the field of planning for which an organization such as the General Staff was needed was the study made in 1912 on the "Organization of the Land Forces of the United States"[34] which formulated the broad outlines of a comprehensive military policy. By considering and discussing such factors as the traditional military policy of the United States, the distribution of the mobile army and its relation to tactical organization and administration, the requirements and need of a reserve system, the relation of promotion to organization, the raising and organizing of the national volunteer force, and considerations affecting the strength, composition, and organization of the land forces of the United States, this study brought together the many elements of the problem of national defense in a way that invited intelligent consideration by Congress and the interested citizenry of the country to whom the study was made available by being printed in pamphlet form and widely distributed. Doubtless Congress did not pay too much attention at that time to this sixty-three page, finely printed study for no immediate action followed its release. In a sense the study might have been labelled as propaganda and no doubt it was so called in many quarters inasmuch as the report followed in the wake of General Wood's campaign for preparedness. However, none of the common propaganda devices appeared in the study. On the contrary, the study had all the usually recognizable earmarks and dullness of a government document. The greater part of the report was devoted to a consideration of the factors that merited attention if the problem of national defense was to be approached intelligently. While the report did contain substantial legislative recommendations, its chief services were educational.

Two years later, in September, 1915, another General Staff study entitled "A Statement of Proper Military Policy"[35] was released. This report was prepared by the War College Division of the General Staff in response to a directive from the Secretary of War which instructed the General Staff "to make a complete and exhaustive study of a proper military policy for the United States, and to prepare a clearly and succinctly expressed statement of the policy basing it, in a general way,

[34] Published as Appendix "A" in the Report of the Secretary of War for 1912, War Department Annual Reports.
[35] War Department Annual Reports, 1915.

upon the 'Report on the Organization of the Land Forces of the United States, 1912' eliminating everything that is not necessary for the quick and easy comprehension of the military policy, and adding anything which may be necessary to afford such comprehension."[36] After six months of study, the military planners made their report[37] which was included in the 1915 Annual Report of the War Department. This document is of interest because it illustrates a very excellent approach to a problem in planning. First of all, the various factors which enter into military policy were examined and evaluated. Then, it was noted how our national policies and the strength of foreign armies dictated the size and kind of an army that was needed for the United States. This was followed by a detailed description and an estimate of the cost of maintaining such an army. With this as a basis Congress or the administration could view the problem in its entirety and indicate to what extent approval would be given. Contrast this with the practice of Congress nibbling piecemeal at a problem through scrutiny of a mass of individual appropriation items.

UTILITY OF GENERAL STAFF PLANNING

How useful were these efforts of the General Staff planners? A conclusive answer cannot be given for the evidence is contradictory. There were many who believed that the General Staff was merely following a trend rather than setting one. Such individuals believed that the trouble with Mexico and the outbreak of the first World War in 1914 were responsible for the congressional action taken. However, the majority of informed observers seem to be of the opinion that the General Staff planning agencies played the major role in bringing into existence the National Defense Acts of 1916 and 1920. Certainly the resulting legislation bore a very close family resemblance to the 1912 General Staff study on the "Organization of the Land Forces of the United States" and the 1915 General Staff report on "A Statement of Proper Military Policy". Congress materially reduced the General Staff estimates on numbers needed but accepted the general structure proposed by the General Staff. Commenting on the National Defense Act of June 3, 1916, the Secretary of War in his 1916 report observed

[36] *Ibid*, p. 113.
[37] *Ibid*, vol. I, pp. 111–112.

that this was the "first comprehensive legislation for national defense"[38] ever enacted. Some credit for this achievement of comprehensive legislation for national defense may properly be given to the General Staff planning agencies.

The War Department experience reveals that to a certain extent the planning agency is always on the spot. During the period when General Wood was Chief of Staff, the War Department General Staff in its planning activities had tried to tell Congress what to do. The General Staff wanted a preparedness program which would have cost huge sums; the people were sensitive to the high cost of living. Congress with its ears very properly to the ground refused to accept any program which would have increased expenditures and necessitated higher taxes. The General Staff was roundly criticized for not confining its attention to its proper level—planning within the confines set by Congress. Between 1916 and the entrance of the United States into the World War, the General Staff did hold back and worked in the area directed by Congress and the administration. The lack of foresight on the part of Congress and the neutrality policy pursued by President Wilson virtually closed the door to anything but the routine preparation of paper war plans. When war came, however, the War Department was roundly criticized for its failure to plan properly and anticipate the situation. Administrative planning to be effective must rest on the foundation of directives acceptable to or announced by the legislative branch and arrived at by political processes. The attempt of the War Department planners to cajole Congress and the people into adopting directives desired by the planners had proved disastrous. The spectacle of administrative planners sitting back while Congress temporized or pursued policies dictated by day-to-day expediency and subject to complete reversal overnight was equally unsatisfactory. As early as 1910, the War Department planners recognized the existence of the dilemma and recommended to Congress a plan which, it was hoped, would remedy the situation. This plan provided "for the establishment of a Council of National Defense, containing representatives from both the War and Navy Departments, the Army and the Navy, and from both Houses

[38] War Department Annual Reports, 1916, Report of the Secretary of War, p. 163.

of Congress".[39] In his 1912 report the Secretary of War stated that the passage of such a bill would "tend to bring the Executive and the Legislature into more harmonious and intelligent relations on the vital and technical questions which underlie our national defense, and that the recommendations of such a council would thus greatly facilitate the work of Congress on this subject".[40] This proposal was never accepted for although a Council of National Defense was constituted in 1916, its membership was limited to cabinet officers, the Secretaries of War, Navy, Interior, Agriculture, Commerce, and Labor being members.

Lest too rosy a picture has been presented of the experiences and incidents relating to War Department planning during the period 1903 to 1917, a sour note will be mentioned. There are a few army officers who believe that very little was accomplished during this period in the way of effective planning. Echoing this view, General Johnson Hagood wrote as follows:

> The fourteen years, 1903 to 1917, during which the General Staff had been in existence had not been spent in making plans for war, the purpose for which it was created, but in squabbling over the control of the routine peace-time administration and supply of the Regular Army and in the attempts to place the blame for unpreparedness upon Congress. The General Staff wanted more money and Congress—the people—would not give it. They wanted more soldiers and a little smattering of reserve supplies. But our unpreparedness did not come from lack of money, lack of soldiers, or lack of supplies. It came from a lack of brains, or perhaps it would be fairer to say, lack of genius. . . . Pages could be written upon what the General Staff should have been doing between 1903 and 1917. . . . The whole General Staff and War Department organization, generally, fell like a house of cards and a new organization had to be created during the process of the war. . . . As I was on duty in the War Department for seven of the fourteen years of misspent energy, it might be asked why, seeing these things, did I not do something to correct them? The answer is that I did not see them or, seeing them, did not understand. Hindsight is better than foresight, and I, like all the rest, did not have the brains—or the genius—to see preparedness in its true light.[41]

[39] War Department Annual Reports, 1912, Report of the Secretary of War, vol. I, p. 28.
[40] *Loc. cit.*
[41] Hagood, *op cit.*, pp. 22–27.

General Hagood's views have been quoted not only to round out the picture but to focus attention on what is the all-important factor, the personnel who staff the planning agency. This is such a commonplace and universally accepted notion that it is likely to be overlooked. The General Staff planning agencies as a part of the War Department organizational structure are theoretically of great value but practically are of little or great utility, depending entirely on the calibre of the individuals who run them. On the whole, the most promising officers of the army have been selected for this duty. Their tour of duty has been limited to four years so that touch will not be lost with army developments in the field. Limited tenure also guards against mental sterility that sometimes comes as a consequence of being on the same job for too long a period. Perhaps the gravest defect has been in the selection of some older officers who, although of superior competence in some specialized routine of army activity, have lost that breadth of vision and habit of thought so necessary to the planning role. Planning with its emphasis on the consideration of future developments will always face attack from those whose habits, temperament, and mode of thinking bind them to past ways.

PLANNING FOR INDUSTRIAL MOBILIZATION

Since 1920, the most interesting development in War Department planning has taken place in the office of the Assistant Secretary of War. A great amount of time and effort has been expended in planning for industrial mobilization in event of war. While the efficacy of such planning awaits a future test, the experience in this field is of interest for the work therein illustrates many of the problems of administrative planning. At the very outset, however, several distinguishing features should be noted. The problem thrust into the hands of the planners is as complex and elusive of solution as any that government has been called upon to solve. In this connection it is pertinent to state that the analysis of planning for industrial mobilization which follows is necessarily cursory. Another item worthy of note is that many of the elements which must be considered in this work are full of political dynamite. Some of these political combustibles are susceptible to such easy detonation that few Congressmen and Senators are willing to take them in hand. And finally, the progress made in industrial mobilization plan-

ning reveals how planning on the administrative level brings to light and focuses attention on grave questions of policy and prepares the ground, so to speak, for their intelligent consideration. This educational activity and the practice of airing the problems before the political and industrial leaders of the country in order to obtain their views has produced a better understanding on the part of everyone.

To understand the post-war developments in industrial mobilization planning, it is essential to know at least the bare outline of our war-time experiences. Prior to 1916 the War Department had rested on the comfortable assumption that supplies of all kinds would be readily forthcoming if Congress only made the necessary funds available. It is only fair to state that during the years from 1909 to 1916 the Quartermaster Department did try to obtain a war reserve of needed supplies. Some appropriations were made for this purpose but the concentration of troops on the Mexican border incident to the trouble with Mexico during the Wilson administration had exhausted all the surplus stocks. When war clouds were gathering in 1917, the Quartermaster Department was naturally making every effort to get ready to play its designated part. The question as to how the large problem of over-all coördination was to be effected had not been settled by Congress and without some decision by Congress the Quartermaster General could not proceed very far. The first thought on the subject was that the United States Chamber of Commerce would act as the medium to organize industry and would establish an organization that would parallel for industry the decentralized depot organization of the Quartermaster's Department. However, the development did not follow this line.

Instead, a more centralized organization resulted from the efforts started by the Council of National Defense. In 1916 when the navy became engaged in a large building program, a Naval Consulting Board was established with Thomas A. Edison as the head and with two members appointed from each of the great scientific societies of the country. This Naval Consulting Board appointed a Committee on Industrial Preparedness with Howard Coffin as Chairman. Supported by private contributions, this committee by appointing a sub-committee in each state compiled an inventory of the manufacturing plants capable of making munitions. Appropriating $200,000 for in-

dustrial preparedness, the Army Appropriation Act of August, 1916, established a Council of National Defense, consisting of the Secretary of War as Chairman and the Secretaries of Navy, Interior, Agriculture, Commerce, and Labor as members. This body was to study the problems incident to industrial mobilization and was to present their recommendations to Congress as the basis for future legislation. The measure provided for the creation of an Advisory Commission not to exceed seven men selected for their special knowledge of industry and national resources, who were to advise the Council of National Defense. Along similar lines was the provision of Section 121 of the National Defense Act of June 3, 1916, which directed the Secretary of War to appoint a board of three army officers and two civilians to investigate and report to Congress by January 1, 1917, the feasibility, desirability, and practicability of the manufacture by the government of arms, ammunitions, and equipment.

While the Advisory Commission to the Council of National Defense had no power, some of its interested members did survey the railroads and the steel industry. When the United States severed diplomatic relations with Germany in February, 1917, the Advisory Commission and the Council of National Defense hurriedly went to work. Incident to conferences with the leading men in each branch of industry related to a possible war effort, the Council of National Defense asked that a committee of not more than three men be designated to represent each phase of industry. This was the genesis of the Commodity Sections and War Service Committees which were to function later under the War Industries Board. On February 28, 1917, the Council of National Defense appointed a Munitions Standards Board, composed of technically qualified individuals who were to coöperate with the War and Navy Departments in establishing standards for the manufacture of war supplies. A month later a General Munitions Board was appointed to organize and coördinate the purchases of the War and Navy Departments and to assist in the development of plants for the manufacture of war supplies and of facilities for providing necessary raw materials. This new board included the members of the Munitions Standards Board and representatives of the army and navy. With a membership of twenty-two, this board was unwieldy and in attempting to function by means of various

sub-committees its action was lethargic. On July 8, 1917, the Council of National Defense dissolved the General Munitions Board of twenty-two members and established a War Industries Board of seven members who functioned collectively as a policy determining committee and who as individuals headed such activities as Raw Materials, Finished Products, Priority Control, Labor, et cetera. On March 4, 1918, President Wilson removed the War Industries Board from the jurisdiction of the Council of National Defense and gave to its Chairman, Mr. Bernard Baruch, the authority to act in the name of the President to the extent necessary to control and regulate industry as the war needs dictated. The War Industries Board, acting as a legislative body, laid down the general measures of control, subject to the absolute veto of its chairman, Mr. Baruch. The members of the War Industries Board as individuals became executives who carried out functional duties through a series of committees of which the War Industries Board members were chairmen. The committees were Price Fixing, Purchasing Commission for the Allies, Explosives, Labor, Planning and Statistics, Requirements, Chemicals, Facilities, Priorities, Finished Products, Steel, Textile, and Conservation. Under these committees were the appropriate Commodity Sections who furnished all the information on their particular commodity and who transmitted to their branch of industry the decisions or instructions of the War Industries Board or its various committees. For each Commodity Section there was a parallel War Service Committee acting as the representative of the business firms in that line of work.

In theory, the process had been well thought out. The Requirements Division of the War Industries Board was supposed to compile the total requirements of the various government agencies by getting the amounts needed, together with a time schedule showing when delivery was necessary. This information had to be obtained from the many purchasing agencies of the government and of the Allies. In addition, the needs of the civilian population were estimated. There then would emerge a master schedule which measured the demand of all the war-time agencies and the country for all the various products. This information was transmitted to the War Industries Board who broke it down and sent the necessary figures to each of the sixty-six Commodity Sections. In brief,

this was the process of ascertaining the demand side of the picture.

Going to the supply side of the project, a similar arrangement operated. Each Commodity Section, knowing the total demand for the commodity over which they exercised supervision, then made a study to see how this quota could be supplied. In case the requirements could be met, the problem was solved by apportioning through the War Service Committee for that industry the orders for the various individual firms. In case the facilities were inadequate to supply the amount needed, the appropriate Commodity Section informed the Clearance Division, the Conservation Division, and the Conversion and Resources Division of the War Industries Board, whose job it was to augment the supply of articles of which there existed a shortage. Voluntary coöperation on the part of capital, labor, and management was the moving spirit behind the plan. While the very effective controls of priority classification, clearance arrangements, and even commandeering were available, they seldom had to be invoked. The knowledge that they could be used was usually all that was needed to transform the very very few recalcitrants into eager coöperators.

Above all, it should be remembered that this plan of operation was the goal to be achieved and was not even approached until the closing month of the war. The war period was largely characterized by hasty and frantic improvisation. As these external aids to its operation were slow in taking shape and began to act too often only after trouble arose, the War Department through internal reorganization attempted to smooth out the frequent snarls. When the United States entered the war there were some seven separate War Department bureaus who did their own purchasing. The rapid creation of additional War Department entities and the mushroom growth of other government war agencies swelled the ranks of competing government bidders. It was only natural that each agency in its own sphere tried to carry out the job assigned to it even if it involved cornering the entire supply of an item and leaving some other bureau who also needed the product completely out of the picture. The railroad congestion extending for hundreds of miles around our eastern seaboard added to the difficulty. Constant changes and improvements in the specifications of the munitions needed were cabled from France. In addition, the

basic unit, the division, on which supply requirements were calculated was greatly increased in man power and the number of divisions to be sent to France was increased. In short, the details of our war effort were constantly changing. By December, 1917, the supply program was in such a mess that it was a miracle that it was ever unraveled. In an effort to break the jam the General Staff Division of Purchases, Storage, and Transportation took over the operating activities of several of the army supply bureaus.

As soon as the war ended, it was only natural that our war experiences should be thoroughly reëxamined and that criticisms suppressed during war time be unleashed. It was commonly accepted that our greatest error in the war had been our failure to appreciate the complexity of industrial mobilization for war and the overwhelming importance of the time factor. Time-consuming industrial processes although speeded up were largely irretrievable. The desirability of enthusiastic voluntary coöperation on the part of industry and labor was generally recognized and applauded. However, there was a considerable amount of criticism of the cost plus ten per cent feature found in many of the war time contracts. There was also some hard feeling manifested by individuals serving in the armed forces at thirty dollars a month against those workmen who earned ten to fifteen dollars a day in industry even though such work was essential to our war effort. Likewise, the rapid advancement in industry of some who stayed at home was resented for in many cases it was at the expense of those who had volunteered or who had been drafted into the military service.

All of these elements entered into the post war consideration of the problem of planning for industrial mobilization. After lengthy discussion Congress incorporated into the National Defense Act of 1920, Section 5a which provided that:

> The Assistant Secretary of War, under the direction of the Secretary of War, shall be charged with the supervision of the procurement of all military supplies and other business of the War Department pertaining thereto and the assurance of adequate provision for the mobilization of materiel and industrial organizations essential to war time needs. There shall be detailed to the office of the Assistant Secretary of War from the branches engaged in procurement such number of officers and civilian employees as may be authorized by regulations approved by the Secretary of War. . . . Under the

direction of the Secretary of War chiefs of branches of the Army charged with the procurement of supplies for the Army shall report direct to the Assistant Secretary of War regarding all matters of procurement. . . .[42]

The directive which the National Defense Act of 1920 gave to the Assistant Secretary of War was both a planner's dream and a nightmare. The World War had demonstrated that modern war required some six or seven industrial toilers in the workshops of the nation to support one fighting man at the front. The capacity to wage war had become a derivative of a nation's industrial might. Industrial mobilization was a very broad term—it could mean anything from a clerical computation of army needs given certain stipulations or it could embrace plans that involved the mobilization of industry under government direction until the extreme of totalitarian government was reached.

The office of the Assistant Secretary of War necessarily began on a modest basis. The stimulating part of the work was that each plan revealed additional factors that had to be considered and which emphasized the need for more comprehensive planning. Likewise, with the growth of the various sections in the office of the Assistant Secretary more and more cross-relationships developed between the various War Department offices and army organization. For instance, Air Corps procurement problems involved complex relationships between the Commanding General, G. H. Q. Air Force, the War Department General Staff, the Chief of the Air Corps, and the Air Corps schools and the testing and experimental stations, and the various sections of the office of the Assistant Secretary of War. To complicate the problem further the needs of the navy and of the civilian population could not be disregarded.

The first task which was tackled by the planners in the Assistant Secretary of War's office was the problem of computing the supply requirements. The War Department General Staff was charged with the duty of drawing up tables of organization, tables of equipment, and the setting of replacement and allowance schedules. The War Plans Division of the War Department General Staff initiated studies which determined the number and type of troops which would be needed in any

[42] Act of June 4, 1920. Chapter I, Section 5a.

assumed situation. The supply branches under the directive thus formulated by the General Staff then computed the detailed supply requirements. After this was approved by the Secretary of War the procurement task of the office of the Assistant Secretary of War began. Under the supervision of this office the supply branches then converted the supply requirements into procurement requirements by determining when and where the various items would be needed. In 1926 after mature deliberation the office of the Assistant Secretary of War decided that more attention had to be devoted to the preparation of specifications and that a greater effort should be made in the direction of standardizing the various items. The War Department General Staff was charged with the task of specifying what the military characteristics of the item should be. The appropriate supply branch then developed the desired article which was given to the appropriate operating arm for testing. If satisfactory, standardization of the article would be recommended. Standardization was a responsibility of the General Staff. After standardization the supply branches under the supervision of the office of the Assistant Secretary of War prepared the necessary specifications which after completion were then cleared for procurement. A very large amount of coöperation was essential in order to gain any amount of standardization. The tendency was toward indefinite postponement for the using arms, such as the Infantry, Artillery, and Cavalry, and the technical services, such as the Ordnance, continually preferred to make and suggest improvements in weapons and items of equipment. The attitude of never being quite satisfied was meritorious but it delayed standardization. Procurement planning in a certain sense thus appeared to be the enemy of progress.

The next step was the survey and the allocation of manufacturing facilities. It was this task which greatly widened the scope of the planner's studies. The navy's needs and the problem of what constituted necessary industrial production for civilian use entered the picture. The Joint Army and Navy Board, the Army and Navy Munitions Board, and the Procurement Division of the Treasury are all concerned with this phase of the problem. For a period the navy was not greatly interested in the allocation of facilities as the problem of war expansion did not approach that of the army. At best, any war time

navy could be increased only slightly and at a slow rate over its peace time size. The army on the other hand contemplated a huge expansion. Thus, the army at one time had some 12,000 plants allocated to it while the navy had but some 300.

At first, computation of production from the manufacturing facilities allocated to the various supply branches of the army by the procurement planners was necessarily crude. Nevertheless, the work along this line produced a major triumph which in itself justified all the planning work which had been going on since 1920. The planners in the field of industrial mobilization discovered that the General Staff had adopted a mobilization plan which would have produced the same supply crisis that occurred during the World War. The Secretary of War described the situation in his 1938 report to the President as follows:

Mr. President:

During my tenure of office as Assistant Secretary of War from 1933 to 1936 I became convinced that the then current War Department plan for mobilization in the event of a major emergency contained discrepancies between the programs for procurement of personnel and procurement of supplies which were so incompatible that the plan would prove ineffective in war time. The basic War Department mobilization plan had its genesis in the days of the World War. It was a plan worked out conscientiously by officers of high military attainments, who, as the result of their war time experience, naturally thought in terms of the vast army of millions mobilized for World War service. It was a plan that contemplated the use of great surpluses of supplies accumulated after the World War—supplies which by 1936 had become greatly depleted or obsolete. Furthermore, it was a plan that called for the maintenance of huge reserve supplies requiring expenditures of sums which the Congress never found it feasible to appropriate.

My duties as Assistant Secretary of War specifically charged me by law with responsibility for the 'assurance of adequate provision for the mobilization of materiel and industrial organizations essential to war-time needs.' It became evident to me that the War Department mobilization plan then current was gravely defective in that supplies required during the first months of a major war could not be procured from industry in sufficient quantities to meet the requirements of the mobilization program.

When I assumed the duties of Secretary of War, the General Staff had under consideration a revision of the basic War Depart-

ment mobilization plan. . . . One of the first directives issued by me as Secretary of War was that the General Staff restudy the whole intricate problem of emergency mobilization with a view to complete replacement of the then current War Department mobilization plan with a program that would prove completely adequate and thoroughly practicable. . . . The result of that study is now found in what we term the protective mobilization plan of 1937. The 1937 plan has not been perfected; details remain to be worked out and are being worked out thoroughly and diligently. . . . I believe the reduction of our mobilization program to sensible workable proportions to be one of the highest attainments of the War Department since the World War.[43]

In 1937 procurement planning was carried one step further. Congress authorized[44] the placing of educational orders for munitions and provided yearly appropriations for this purpose. This will materially assist in bringing the paper plans for the allocation of manufacturing facilities into the realm of reality.

That part of planning for industrial mobilization which relates to the compilation of procurement requirements and the allocation of industrial concerns to the various interested supply arms illustrates what would normally be regarded as proper administrative planning. This work has demonstrated the practical utility of planning and has made a particularly important contribution in calling attention to the inability of the supply factors to keep pace with the then current mobilization plan for personnel. Irrespective of the efficiency of the individual supply bureaus, they could not have been expected to pick this major error. No single bureau could be aware of the combined picture. And more important, each bureau was fully occupied with the press of current business; no time was available for the deliberative function of planning.

It is significant that procurement planning on the administrative level pointed the way and emphasized the need for broader policy planning. As the office of the Assistant Secretary of War pushed further and further into the field of procurement planning (determination of requirements and plans for the procurement of such items), it was realized that there was a second phase that could not be avoided. The success of procurement planning depended upon the effectiveness of measures which

[43] War Department Annual Report, 1938, Report of the Secretary of War, p. 1.
[44] Public No. 639, 75th Congress.

would be adopted in time of war for the control of the economic resources of the entire country and the mobilization of industry in general. At first, this latter field was avoided for it was properly held that these larger matters involved basic decisions on national policy which were far beyond the ken of the army. A very comfortable solution was arrived at shortly thereafter. The 1936 revision of the Industrial Mobilization blandly stated that the essentials of a complete plan included two steps: procurement planning which involved the determination of needs and the plans for the procurement of these requirements; and plans for the control of economic resources and mobilization of industry. Step one was a responsibility of the War and Navy Departments while step two was up to the President and Congress.[45] However, in the absence of congressional action on the broader phases of the problem, the office of the Assistant Secretary of War decided that they should consider what steps should be taken so as to be in a position to advise Congress and the President when and if their advice was desired. This overall planning involved the study of many controversial issues. The sky was the limit when it came to the determination of measures that should be adopted to insure proper coördination and use of the nation's resources and that would provide the necessary administrative machinery and organization to execute the necessary control measures.

An interesting phase of this planning activity was the relationship with Congress. As was proper, Congress was asked to decide certain important questions of policy. Some progress along this line was made. Various committees such as the War Policies Commission, created by Public Resolution No. 98, Seventy-first Congress, and composed of six cabinet officers, four Senators, and four members of the House of Representatives held extensive hearings on the subject. Senator Nye sponsored a munitions investigation. A considerable number of bills have been introduced at various times in Congress. Yet no substantial decisions have been reached. While there has been a great measure of agreement on the purposes and aims to be attained, conflicts have arisen over the methods and mechanisms to be used. These disagreements hark back to the criticisms voiced in 1919 and 1920. The American Legion has been interested in plans to take the profits out of war. Very few object

[45] Industrial Mobilization Plan, 1936 Revision (Washington, D. C.), p. xi.

to this idea but no acceptable way to do it has been achieved. The planners in the Assistant Secretary of War's office are very vitally interested in this activity for it underlies a vexing problem. Procurement planning has progressed to a point where contracts for various items can actually be given to a very large number of manufacturers who will then be in a position to start production on very short notice in case of war. The big stumbling block to speed is the matter of price. The War Department is anxious to eliminate the cost plus a percentage profit feature of the 1918 war contracts. Contracts specifying a set price will be difficult to achieve if costs are permitted to skyrocket. The office of the Assistant Secretary of War has attempted a solution by drawing up after much study six types of war contract forms which cover all possible cases.[46] An interesting feature of this development is that set prices are to be approached by specifying a price but by further providing for recourse to court action for adjustments made necessary by unforeseen changes in costs over which the manufacturer has no control. At best, these remedies are stop gaps. In addition, they can be criticized for the vast amount of court action which will result.

To take the profits out of war by the application of confiscatory taxation is another proposal accepted by everyone. But here again a workable formula has been difficult to find. The War Department planners have apparently taken the viewpoint that plans for war time taxation should emanate from congressional or treasury experts. However, in the last session of Congress a war time tax measure was introduced which disappointed these hopes. The Bone war profits tax proposal could not have been the result of careful study for in some cases it provided for taxes in excess of an individual's income. When introduced, this measure had the printed support of fifty Senators, forty-five of whom when interviewed by a curious newspaper reporter admitted that they had not read the bill but had approved its motive. This experience would indicate that the planners in industrial mobilization might well study taxation for, if they do not consider this phase, it apparently will not be carefully studied.

The question of what will be the position of labor in war has

[46] Cf. War Contracts, Lieut. Col. John P. Dinsmore, Army Ordnance, March-April, 1940, vol. XX, No. 119.

been studiously avoided. Spokesmen for the war veterans' organizations have sometimes urged that labor be drafted in the same way that soldiers are drafted for the army and at presumably the same pay. The idea of drafting labor or of placing any restrictions on its freedom in peace or war has been repugnant to the supporters of organized labor who have felt that such regimentation of labor would permanently destroy the rights which labor has gained only after a century of struggle. Members of Congress have occasionally echoed these conflicting views. In the main, however, these are questions which for political reasons Congress will not handle until the immediate necessity of a war situation forces their consideration.

In spite of the disagreement in Congress and its disinclination to act on these important questions of policy, the work of the office of the Assistant Secretary of War in this broad field of war controls has been highly useful. The planners have not attempted to push their views on Congress; they have however rendered an important service by presenting the problem. This makes for public discussion and the formation of public opinion, a necessary preliminary to legislative action. Several examples of this necessary forerunner to action may be cited. A decade ago, a large majority of the citizens of the United States believed that our country was so blessed with natural resources that it was almost completely self-sufficient. By labelling those raw materials which were vital to our war needs as strategic raw materials and by disseminating this information year after year the office of the Assistant Secretary of War gradually built up a more intelligent understanding of this aspect of national defense. Work along this line induced Congress in 1939 to provide funds for the accumulation of stock piles of these strategic raw materials. The question of what industrial controls will be needed has likewise been thrust forward for discussion year after year. Industrial leaders have been invited to lectures and conferences at the Army Industrial College where they have been asked what controls should be instituted and where their proposals have been subject to thoughtful questioning. Through such a procedure the time will come when all the interested groups—management, labor, capital, and the military, who are primarily interested in efficient war time performance—can go to Congress with a plan that is acceptable to all. This takes time. As an indication of the prog-

ress that is being made in this direction, the statement of the Chairman of the Board of the National Association of Manufacturers is of interest. On April 2, 1940, Mr. Howard Coonley stated:

> I think the planning ahead for national defense has been wonderfully done. I think that we in the National Association of Manufacturers now feel that the program is intelligent and cooperative and that we don't feel any itchiness over what is being done today. It's as near a voluntary plan as could be devised.

There is of course a special justification for the emphasis on planning in the field of national defense that is not present in other activities of the government. In non-military governmental problems legislative enactment can be immediately translated into action. In military matters important problems must be anticipated but they cannot be resolved with finality because they hinge on future events which can be but imperfectly foreseen. Some provision must be made prior to the event for time is then of such importance that deliberative action is out of the question. This is well exemplified in the efforts toward industrial mobilization. Because a particular war-time situation cannot be anticipated, plans which can be constantly revised are more desirable than legislation which tends to freeze a solution. In addition, the implication is avoided that measures enacted for war-time situations will be invoked to attain political ends in periods of peace time political crisis.

Planning for industrial mobilization has at least focused the attention of Congress, the army, and the nation on an important problem. How successful the work and study has been cannot be determined with finality until a war time test occurs. It can be said, however, that the approach of the planners of the Assistant Secretary of War's office has been highly successful. Congress has not viewed their efforts with suspicion but instead has encouraged them. Their actions have not been misunderstood by the nation as military high-handedness. Perhaps some explanation of the success of the planners for industrial mobilization may be found in the caption which keynotes the 1939 Revision of the Industrial Mobilization Plan. Quoting Woodrow Wilson, it states that "the highest and best form of efficiency is the spontaneous cooperation of a free people."[47]

[47] Industrial Mobilization Plan, Revision of 1939, Senate Document No. 134, 76th Congress, 2nd Session, p. 1.

CONCLUSION

This cursory examination of administrative planning for national defense suggests that a specialized planning agency has proved useful in the military administrative process. No attempt has been made to demonstrate the practicability of similar agencies in the non-military sphere. Nevertheless, such an implication must be mentioned. This presentation of the pattern of military planning has been designed to invite such a comparison. It is therefore pertinent to quote the observation of Lord Haldane as a conclusion to this phase and as a preface to such a suggested comparison. In their report the Machinery of Government Committee headed by Lord Haldane stated:—

> Turning . . . to the formulation of policy, we have come to the conclusion, after surveying what came before us, that in the sphere of civil government the duty of investigation and thought, as preliminary to action, might with great advantage be more definitely recognized. It appears to us that adequate provision has not been made in the past for the organized acquisition of facts and information, and for the systematic application of thought as preliminary to the settlement of policy and its subsequent administration. . . . This is no new notion. There are well known spheres of action in which the principle has been adopted of placing the business of enquiry and thinking in the hands of persons definitely charged with it, whose duty is to study the future, and work out plans and advise those responsible for policy or engaged in actual administration. The reason for the separation of work has been the proved impracticability of devoting the necessary time to thinking out organization and preparation for action to the mere interstices of the time required for the transaction of business. . . . *But the principle ought by no means to be limited in its application to military and naval affairs. We have come to the conclusion that the business of executive government generally has been seriously embarrassed from the incomplete application to it of similar methods.*[48]

[48] Report of the Machinery of Government Committee, Viscount Haldane of Cloan, Chairman (London: His Majesty's Stationery Office, 1918), p. 6. Italics are the author's.

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* Compiled by Mrs. Helen W. Parsons.